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In The

BRIEFS OF THE CLERK

Supreme Court of the United States**October Term, 1991****QUILL CORPORATION,***Petitioner,*

v.

**STATE OF NORTH DAKOTA, BY AND THROUGH
ITS TAX COMMISSIONER, HEIDI HEITKAMP,***Respondent.***On Writ Of Certiorari To The
Supreme Court Of North Dakota**

**BRIEF OF THE STATES OF CONNECTICUT, TENNESSEE,
CALIFORNIA, ARKANSAS, FLORIDA, GEORGIA,
IDAHO, ILLINOIS, IOWA, KENTUCKY, LOUISIANA,
MARYLAND, MASSACHUSETTS, MICHIGAN,
MISSISSIPPI, NEVADA, NEW YORK, OHIO,
OKLAHOMA, PENNSYLVANIA, SOUTH CAROLINA,
TEXAS, UTAH, VERMONT, VIRGINIA, WASHINGTON,
WEST VIRGINIA AND THE DISTRICT OF COLUMBIA
AS AMICI CURIAE IN SUPPORT OF RESPONDENT**

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No. 91-194

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October Term, 1991

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STATE OF NORTH DAKOTA, BY AND THROUGH ITS TAX COMMISSIONER, HEIDI HEITKAMP,

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BRIEF OF THE STATES OF CONNECTICUT, TENNESSEE, CALIFORNIA, ARKANSAS, FLORIDA, GEORGIA, IDAHO, ILLINOIS, IOWA, KENTUCKY, LOUISIANA, MARYLAND, MASSACHUSETTS, MICHIGAN, MISSISSIPPI, NEVADA, NEW YORK, OHIO, OKLAHOMA, PENNSYLVANIA, SOUTH CAROLINA, TEXAS, UTAH, VERMONT, VIRGINIA, WASHINGTON, WEST VIRGINIA AND THE DISTRICT OF COLUMBIA AS AMICI CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF THE AMICI

Connecticut, Tennessee, California and the other named states submit this brief as *amici curiae* in support of respondent North Dakota, and urge this Court to affirm the ruling of the Supreme Court of North Dakota in *North Dakota v. Quill Corporation*, 490 N.W.2d 203 (N.D.

1991). Since this brief is being filed on behalf of Connecticut, Tennessee, California, Arkansas, District of Columbia, Florida, Georgia, Idaho, Illinois, Iowa, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, Nevada, New York, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas, Utah, Vermont, Virginia, Washington, and West Virginia by their Attorneys General, consent to its filing is not required. U.S. Sup. Ct. R. 37.5.

The issue presented by this case is whether a state can constitutionally require multistate direct marketers that regularly and systematically exploit the state's market to collect the state's use tax. This issue is of vital importance to all 46 states¹ that impose sales and use taxes. In fact, at least 34 states, including North Dakota, have specifically amended their tax statutes to impose tax collection obligations upon direct marketers headquartered out-of-state.²

It is estimated that in 1985, as a result of their continued reliance on this Court's decision in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967), direct marketers failed to collect state and local use taxes amounting to more than one billion dollars. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS (ACIR), NO. A-105, STATE AND LOCAL TAXATION OF OUT-OF-STATE MAIL ORDER SALES (Apr. 1986). By 1990, the estimated revenue loss to all states had grown to over three-and-a-half billion dollars. ACIR, REVISED REVENUE ESTIMATES, 1990-1992 (Dec. 1991). In addition, the tax-free advantage for multi-state sellers created by *Bellas Hess* has unfairly undermined the efforts of local retailers to compete in the marketplace, thereby compounding the impact on the

states. The continued application of the *Bellas Hess* holding in this manner is obviously of grave interest to the *amici* states because of the enormous impact that ruling has had on state and local tax revenues.

SUMMARY OF ARGUMENT

1. The *National Bellas Hess* decision was based upon the now-defunct view that any state taxation of exclusively interstate commerce, regardless of the subject's connection to the taxing state and the nondiscriminatory nature of the tax being imposed, is prohibited. *Spector Motor Service v. O'Connor*, 340 U.S. 602, 610 (1951); *Freeman v. Hewit*, 329 U.S. 249, 253 (1946). The old analysis created an immunity from state taxation for corporations engaging in interstate commerce and effectively established a tax-free haven for direct marketing companies.

In the years since 1967, this underlying philosophy has been abandoned by this Court. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), held that interstate commerce should pay its fair share through local taxation, so long as there is sufficient connection to the taxing state, the tax is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to benefits received by the taxpayer. All four of these factors are satisfied in this and similar cases in which multistate direct marketing businesses purposefully avail themselves of local markets and services provided by state and local governments. The petitioner's insistence upon physical presence as the sole determinant of nexus contradicts the very purposes of the Commerce Clause and Due Process Clause, and results in an unfair advantage to multistate direct marketers. This Court should reject the petitioner's argument and recognize, as it did in *Goldberg v. Sweet*, 488 U.S. 252 (1989), that modern developments in technology and commerce require a more realistic approach to taxing jurisdiction.

2. The dramatic success of the direct marketing business since 1967, fostered by new technology and

¹ Sales and use taxes are imposed in all states except Delaware, Montana, New Hampshire, and Oregon. See 1A ALL STATES SALES TAX REP., ¶ 8-410 (CCH).

² See list of states and statutes in Appendix A, at 1a.

exhibited in the significant business presence of such firms in local markets, has had an enormous impact on the states. Total mail order sales have soared from an estimated \$2.4 billion in 1967 to as much as \$183 billion in 1989. Computers have enabled companies located in one corner of the country to target potential customers throughout the nation with surgical precision, and to service those customers and process their orders more quickly and efficiently than they could with an army of door-to-door salesmen. Simultaneously, the de facto tax-exempt status of out-of-state companies has given those firms an unfair competitive advantage over local retailers. Certainly, the Commerce Clause was never intended to encourage tax evasion, and yet even direct marketers themselves concede that the states have lost over \$9 billion since 1985 in uncollected use taxes on sales by multistate direct marketers.

This Court should end this inequity by holding that direct marketing companies that purposefully avail themselves of a state's market to their economic advantage can be required to collect use taxes from that state's residents.

3. Direct marketers benefit greatly from services provided by their market states. The enjoyment of these services establishes nexus and satisfies the fourth prong of the *Complete Auto* test. State and local governments, through their roads, schools, commercial laws, courts, and other general services, promote an organized and civilized society which, under *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981), is a sufficient benefit to demonstrate taxing jurisdiction. These governments also provide services that especially benefit direct marketers, such as local disposal of the hundreds of tons of catalogs purposefully directed into the market states. If the presence of a single solicitor is sufficient nexus, then surely the presence of so many catalogs, necessitating eventual disposal by state and local governments, establishes nexus. States also assure the provision of reliable telephone service through regulation of local telephone

exchanges, and regulate the financial institutions that issue credit cards that direct marketers accept in payment for their merchandise. Credit cards and telephonic contacts, both of which are regulated and promoted by the states, are essential in enabling direct marketers to achieve their current penetration of local markets.

4. The burden that direct marketers bear in collecting the use taxes of those states and localities in which they sell their products is commensurate with the benefits they derive from those states. The same computer technology that direct marketers use to target potential customers and to keep their own records enables them to comply easily and inexpensively with the use tax laws of the states into which they send their merchandise.

ARGUMENT

I.

BELLAS HESS IS FUNDAMENTALLY INCONSISTENT WITH THE MODERN UNDERSTANDING OF THE COMMERCE CLAUSE, ESPECIALLY IN TODAY'S MARKETPLACE.

A rule which grants certain out-of-state businesses de facto tax immunity and thus a substantial competitive advantage over local firms, notwithstanding the numerous benefits and contacts enjoyed by the nonresidents in their targeted market states, contradicts the fundamental purposes of the Commerce and Due Process Clauses. Those basic concerns, which include free trade and fundamental fairness, are ill-served by any renewed adherence to the *Bellas Hess* decision, which has long since been reduced to an anachronism by the evolution of Commerce and Due Process Clause jurisprudence as well as by overarching changes in business and technology.

A. The Formalist Doctrine Immunizing Purely Interstate Commerce From State Taxation Has Been Abandoned.

When this Court decided *National Bellas Hess* nearly twenty-five years ago, it viewed the issues presented through the prism of its time, both factually and legally. Factually, the so-called mail order industry was in its infancy, both technologically and in terms of its economic impact on local markets. Legally, Commerce Clause jurisprudence in 1967 still followed the now-defunct view that purely interstate commerce was immune from state taxation, without regard to the subject's connections to the taxing state or the nondiscriminatory nature of the tax being imposed. *Spector Motor Service v. O'Connor*, 340 U.S. 602, 610 (1951); *Freeman v. Hewit*, 329 U.S. 249, 253 (1946). It was in this context that the *Bellas Hess* Court declared the imposition of use-tax-collection responsibilities upon multistate mail order companies unconstitutional as an unacceptable local intrusion into the arena of interstate commerce. 386 U.S. at 759-760. See generally Rothfeld, *Mail Order Sales and State Jurisdiction to Tax*, Tax Notes, Dec. 23, 1991; Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 VAND. L. REV. 993 (1986).

Since 1967, however, this Court has directly repudiated that principle. In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), the Court unanimously overruled *Spector Motor* (430 U.S. at 289) and rejected "the philosophy of [the *Freeman*] rule" (430 U.S. at 288). Insisting on an approach to Commerce Clause questions based on "economic realities" (430 U.S. at 279), the Court explicitly abandoned what it has since aptly described as *Freeman's* "formalistic approach" that kept certain transactions simply out of reach of state taxing authorities. *Trinova Corp. v. Michigan Dep't of Treasury*, ___ U.S. ___, 111 S.Ct. 818, 828 (1991). The critical doctrinal underpinning of *Bellas Hess* is thus no longer appropriate.

With *Complete Auto*, interstate commerce can now "be made to pay its way" through local taxation, as long as the taxed activity is sufficiently connected to the taxing state, the tax is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to benefits received by the taxpayer. 430 U.S. at 284, 287. This fundamental change in the law itself compels alteration of *Bellas Hess* to comport with the more realistic, modern approach embodied in *Complete Auto*.

All four of the *Complete Auto* factors are satisfied in cases such as the present one in which multistate direct marketing businesses purposefully avail themselves of local markets and are asked only to collect a use tax from in-state residents who purchase goods for local consumption. Such a collection responsibility, applied uniformly to sales made by in-state and out-of-state retailers, and which cannot result in compounding the tax, is fairly apportioned and does not discriminate against interstate commerce, thus satisfying the second and third prongs of *Complete Auto*. As discussed *infra* at Part III, the nonresident multistate retailers enjoy significant benefits from their market states, thus satisfying the fourth prong of the analysis, that the tax be "fairly related to services provided by the state." 430 U.S. at 279. Finally, the substantial contacts and pervasive business presence of such marketers within the taxing states today satisfy the *Complete Auto* nexus requirement.

B. Reliance On Physical Presence As The Essential Precondition to State Taxing Jurisdiction Is Neither Constitutionally Nor Practically Realistic.

The *Bellas Hess* Court's rejection of Illinois's use tax statute was based largely on its concern about taxing interstate commerce at all. Specifically noting that it was "difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved," the Court ruled that the duty

of collecting use taxes could not be imposed on businesses whose only connection with the taxing state was "by common carrier or the United States mail." *Id.* at 758, 759. In the years since *Bellas Hess* was decided, many courts and commentators have interpreted that decision to stand for the proposition that actual physical presence within the taxing state – even if it is the presence of only "a few warm bodies" – is constitutionally necessary for a state to require collection of its tax. See, e.g., *SFA Folio Collections, Inc. v. Bannon*, 217 Conn. 220, 585 A.2d 666 (1991); Hartman, *supra*, 39 VAND. L. REV. at 1014; petitioner's brief at 32. The decision in *Bellas Hess* has thus ossified into a rigid rule that out-of-state direct marketing companies can never be made to collect state use taxes, a rule that is outdated and inconsistent with current constitutional analysis.³

Petitioner asks this Court rigidly to require physical presence as a sine qua non of nexus, regardless of the nature and extent of commercial activities within a taxing state. The only proffered justification for applying such a wooden and unrealistic standard is purported ease of application. But the Commerce Clause cannot be interpreted merely for administrative convenience. As this Court has held, "Administrative convenience, in this instance, is insufficient justification for abandoning the principle that 'interstate commerce may be made to pay its way.'" *Complete Auto*, 430 U.S. at 288 n.15.

In closely related areas of constitutional law, this Court has readily moved away from strict requirements of physical presence. Instead, the Court has adopted a more flexible and realistic approach, focusing on whether

³ Justice Rutledge's dissent in *McLeod v. Dilworth*, 322 U.S. 349 (1944), argues powerfully that economic substance, rather than rigid, technical legal rules, should frame the Court's analysis of state taxing power. Justice Rutledge's analysis was essentially adopted in *Complete Auto*.

a business has "purposefully directed" its commercial efforts at residents of the state. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985). In *Burger King*, the Court noted, in the personal jurisdiction context, that "it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communication across state lines, thus obviating the need for physical presence within a state in which business is conducted." *Id.* at 476. Hartman, *supra*, at 1014. Such an approach is also warranted in the area of use tax collection by direct marketers.

It makes little sense that the presence of a few solicitors or a single office within a state provides a sufficient nexus to require the collection of a state use tax, as in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), yet the calculated exploitation of a state's market by mailing millions of catalogs and reaping billions of dollars in sales does not.⁴ Sales generated by a few solicitors employed by a small out-of-state firm going door-to-door cannot compare to the enormous volume of sales generated within a state by demographically-targeted catalogs produced by a technologically superior direct marketer. And yet, under the petitioner's interpretation of *Bellas Hess*, the former company would be required to collect tax while the latter giant corporation would not. Such a result – particularly one purportedly premised on the Commerce Clause and Due Process – no longer makes sense. Recognizing business presence as the nexus touchstone would comport not only with *Complete Auto* jurisprudence, but with current economic and commercial reality as well.

⁴ For example, in fiscal 1990 alone, one company, Land's End of Chicago, mailed a total of 91,000,000 catalogs averaging 162 pages each to customers throughout the United States, generating hundreds of millions of dollars in sales. See *Lands' End, Inc. v. California State Board of Equalization*, No. 620135, Superior Court of California, San Diego County (appeal pending) (Stipulation, ¶14).

Significantly, in its most recent major decision concerning state taxing jurisdiction, this Court recognized that modern technological developments require an updated and flexible approach to taxing nexus. In *Goldberg v. Sweet*, 488 U.S. 252 (1989), this Court upheld an Illinois tax on the gross charges for interstate telecommunications originated or terminated in Illinois and charged to an Illinois service address. The case arose "against a backdrop of massive technological and legal changes in the telecommunications industry," 488 U.S. at 254, changes that also form the background of the instant case. In affirming the Illinois Supreme Court decision that upheld the tax, this Court abandoned an earlier line of cases because they had "considered a telecommunications technology only distantly related to modern telecommunications technology and were decided in a pre-*Complete Auto* era when this Court held the view that interstate commerce itself could not be taxed." 488 U.S. at 265 n.16. The Court reasoned that the Illinois tax readily satisfied all of *Complete Auto*'s prongs, noting that two states had nexus sufficient to tax an interstate telephone call: the state where the call originates and the state where the call terminates, so long as the call is charged to a service address or billed or paid within the state. 488 U.S. at 263.

In the instant case, the transformation of the mail order industry parallels the changes in telecommunications that lay at the heart of *Goldberg*. In the typical mail order sale, the transaction with the direct marketer originates in the purchaser's state with the placing of an order. The cost of the sale is billed or charged to the purchaser in his home state. Thus considering the analogy to an interstate telephone call, the transaction originates and is paid from the market state. Under *Goldberg*, the purchaser's state would have abundant nexus with the out-of-state direct marketer, sufficient to require collection of sales and use taxes.

In fact, in the context of a mail order sale, the jurisdictions having the "connections" of which *Complete Auto*'s first prong speaks include the purchaser's state and the seller's state. Petitioner, however, claims no duty to report a sales or use tax to any state on most of its business. Since interstate commerce is no longer immune from taxation, a mail order transaction must have nexus somewhere, contrary to petitioner's view that it operates on an ethereal plane immune from all state obligations.

This Court has recognized that *Complete Auto* now requires a reevaluation of the doctrinal underpinnings of many earlier Commerce Clause cases which were based on the *Spector* and *Freeman* assumption of state tax immunity for exclusively interstate business. *Department of Revenue Services v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734, 745-46 (1978). The imposition of a use-tax-collection responsibility on multistate direct marketers like Quill that purposefully and systematically avail themselves of local markets satisfies all four prongs of *Complete Auto*. The petitioner in effect asks this Court to ignore *Complete Auto* and restore the obsolete tax-free trade zone analysis. This argument should be rejected, and the North Dakota statute should be upheld.⁵

⁵ Both courts and commentators have frequently criticized the holding of *Bellas Hess*, especially as it has been applied in recent years to bar use-tax-collection duties for multistate direct marketers in the face of technological and social developments. See Hartman, *supra*; McCray, *Overturning Bellas Hess: Due Process Considerations*, 1985 B.Y.U.L. REV. 265; Rothfeld, *supra*; *North Dakota v. Quill*, *supra*. In a similar situation involving another 1967 case, *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967), this Court recognized the need to update an outmoded precedent, noting that,

Since its announcement, *Schwinn* has been the subject of continuing controversy and confusion, both in the scholarly journals and in federal courts. The great weight of scholarly opinion has been critical of

(Continued on following page)

II.

DRAMATIC DEVELOPMENTS IN DIRECT MARKETING SINCE *BELLAS HESS* HAVE CONTRIBUTED TO THE PERVERSIVE BUSINESS PRESENCE OF THOSE FIRMS WITHIN THE STATES AND HAVE HAD A TREMENDOUS IMPACT ON THE ECONOMIES OF THE STATES.

The dramatic development of the direct marketing industry, and the tremendous economic impact that direct marketing firms have had on targeted states, could not have been envisioned at the time of *Bellas Hess*. These developments make clear that the holding in *Bellas Hess* is unrealistic and unsuited to today's commercial environment.

In 1967, total mail-order sales were estimated at \$2.4 billion. *Bellas Hess*, 386 U.S. at 763 (Fortas, J., dissenting). By 1989, direct marketing sales estimates were in the neighborhood of \$183 billion, *North Dakota v. Quill*, 470 N.W.2d 203, 221 and n.7, up from \$150 billion just four years earlier. *Hartman, supra*, at 1006. Significantly, the rate of growth of direct marketing sales for the period 1974-1985 far exceeded the growth rate of local retail sales. One estimate pegs the rate of growth for this period at more than 200%, or 50%-100% higher than the in-store retail growth rate for the same period. M. SROGE, INSIDE THE LEADING MAIL ORDER HOUSES, ix (3rd ed. 1989).

(Continued from previous page)

the decision, and a number of the federal courts confronted with analogous vertical restrictions have sought to limit its reach. In our view, the experience of the past 10 years should be brought to bear on this subject of considerable commercial importance.

Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 47-49 (1977). See also *Payne v. Tennessee*, 501 U.S. ___, 115 L.Ed.2d 720 (1991)(stare decisis should not prevent reevaluation of constitutional doctrines).

Between 1980 and 1989, it is estimated that direct marketing sales grew at an average rate of 15% a year, compared to an average 5% annual increase in local retail sales. Bruce, *Industry Outlook: What Happens Next*, DM News, June 18, 1990, p. 13. In fact, direct-mail marketing now accounts for between 15% and 25% of all retail sales in this country. Hartman, *supra*, at 1007-08. Just as important, the number of customers responding to direct marketers increased 60% between 1983 and 1989, to an estimated 92 million Americans. TIME, *Read This*, Nov. 26, 1990, at 62-63.

The phenomenal growth of the direct marketing industry over the past twenty years has been made possible by the concomitant revolution in technology available to marketers. As one industry analyst has observed, "The application of computers in mail order marketing has revolutionized the business," increasing profitability by enabling marketers to focus "specifically and exclusively on those prospects most likely to become customers." M. SROGE, *supra*, at viii. The computerized segmentation of target populations based on demographic information has reached a precision which can create targeted customer lists in units "as small as a city block." *Id.* Many direct marketers are very selective in their merchandising, appealing to members of scattered interest groups that are not numerous enough to support a retail store in any one locality, but which provide a lucrative nationwide market. See generally Ulbrich, Changes in the Mail Order Industry Since 1967 (1990) (unpublished paper), Exhibit B to Affidavit of Holley H. Ulbrich in Tennessee's *Bloomingdale's* litigation, reprinted in Appendix B at 6a-26a.⁶

⁶ *Bloomingdale's By Mail Ltd. v. Huddleston*, No. 89-3017-II, Chancery Court of Davidson County, Tennessee (summary judgment entered in favor of the State, upholding the use-tax-collection duty, March 21, 1991), appeal pending before Supreme Court of Tennessee at Nashville, No. 01-S-01-9106-CH-00047 (argued October 3, 1991).

Other technological advances such as toll-free "800" phone lines, fax machines, electronic bulletin boards, cable television, and computer-to-computer linkups, have enabled direct marketing companies to reach into every neighborhood in America more effectively, efficiently, and profitably than an army of solicitors ever could. Developments in the use of credit cards, including instantaneous electronic authorization of credit card purchases, have greatly contributed to the growth of direct marketers' sales over the telephone.⁷

These technological developments – barely imagined in 1967 – show no signs of abating; on the contrary, all indications are that direct marketing will continue to grow. All of these advances in electronic communications, transportation, and the storing and processing of information now enable multistate direct marketers effectively to function as local retailers and to participate fully in state-created markets. The impact of this direct marketing invasion on the economies of the states has been tremendous. It is estimated that uncollected taxes from sales by direct marketers translated into one billion dollars in revenue lost to the states in 1985 (ACIR, No. SR-5, ESTIMATES OF REVENUE POTENTIAL FROM STATE TAXATION OF OUT-OF-STATE MAIL ORDER SALES (Sept. 4, 1987), at 8), and as much as three-and-a-half billion in 1990. ACIR, REVISED REVENUE ESTIMATES, 1990-1992 (Dec. 1991).

The tremendous diversion of income to multistate marketers has created a competitive disadvantage for local retailers and further damaged local economies. Although free interstate competition is the goal of the Commerce Clause, the avoidance of tax on direct marketing purchases gives out-of-state marketers a competitive edge that local retailers cannot match. The amount of

⁷ Indeed, the very term "mail order" used in *Bellas Hess* is obsolete, since most orders are placed electronically over "800" telephone lines, or directly by computer, not by mail.

retail business lost on account of the tax advantage is impossible to calculate with precision, but the price differential caused by the avoidance of tax rates in the five-to-eight percent range undeniably creates a distinct advantage for out-of-state companies, especially on sales of big ticket items. See ACIR, No. A-105, at 5; Rothfeld, *supra*, at 2 & n.15.⁸

The very purpose of the Commerce Clause is to ensure that interstate commerce can compete with local commerce on an even playing field, with no competitive disadvantage to multistate business caused by protectionist local legislation. *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254-256 (1938). Yet the application of *Bellas Hess* to bar use-tax-collection responsibilities has had the undeniable effect of providing a competitive advantage to out-of-state direct marketers over local retailers. See McCray, *Commerce Clause Sanctions Against Taxation of Mail Order Sales: A Re-Evaluation*, 17 URBAN LAWYER at 529, 530 (1985). This unfair competitive advantage has compounded the revenue lost to the states. Since it has reduced sales by local retailers, it has resulted in lower state sales tax receipts from local stores. The loss of sales by local retailers also results in a loss of jobs for local residents and hurts local companies. In the unimpeded interstate economy envisioned by the Commerce Clause, a loss to local retailers as a result of *fair* interstate competition may be constitutionally unavoidable. In this case, however, the loss is occasioned by the *unfair*

⁸ "Looking beyond the revenue loss and resulting inequity, there is the issue of unfair business competition. Through an implicit offer of the opportunity to evade the use tax, a mail order company can begin several percentage points ahead of nationwide mail order companies, such as Sears or J.C. Penney, and every neighborhood merchant - all of whom must collect taxes." Chu, *Stopping Sales Tax Evasion: The Catalogue Loophole Must Be Closed*, N.Y. Times, Aug. 18, 1985; see Hartman, 39 VAND. L. REV. at 1013.

advantage exploited by out-of-state marketers who operate in what has essentially become a tax-free zone. Such a result is not constitutionally mandated and is, indeed, at odds with the purposes of the Commerce Clause.

III.

DIRECT MARKETERS EXPLOIT SUBSTANTIAL CONTACTS WITH THEIR MARKET STATES AND ENJOY SIGNIFICANT BENEFITS PROVIDED BY STATE AND LOCAL GOVERNMENTS.

It is perfectly fair to impose state and local use-tax-collection duties on multistate direct marketers, because the services that state and local governments provide are essential to the success of those businesses. The reality is that direct marketing firms, whether large or small, could not successfully market their products if states and localities did not provide a myriad of services for them. Consequently, multistate direct marketers should share the local tax burdens that support the services from which they benefit.

As early as *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940), this Court observed that an important Due Process concern focuses on "whether the taxing power exerted by the state bears fiscal relation to protections, opportunities and benefits given by the state." 311 U.S. at 441-42. This notion was later formulated as part of the test for state taxing jurisdiction under the Commerce Clause: the fourth prong of the test announced in *Complete Auto* requires that "[t]he tax must be fairly related to benefits and services provided by the State." 430 U.S. at 287. Such services need not correspond precisely to the tax obligation, so long as the taxpayer benefits from the civilized economic and social milieu fostered by the state. See *Goldberg*, 488 U.S. at 267. The point was expressed most

clearly in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, when the Court reiterated its "consistent rule" that,

A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve abandonment of the most fundamental principle of government – that it exists primarily to provide for the common good.

453 U.S. at 622-23 (quoting from *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 521-23 (1937)). Thus this Court already has made clear that for purposes of the *Complete Auto* test, the benefits to the taxpayer need not be direct or proportionate; general government services that facilitate their business are sufficient to establish state taxing power over mail order firms.

Of the myriad of state services that benefit direct marketers, several are readily apparent. State and local governments build and maintain the roads that allow direct marketers to ship their goods from out of state. State-supported school systems educate potential customers with interests, refinements, and desires to which direct marketers can appeal. The states provide other general services that benefit all businesses, such as crime prevention and maintenance of a system of commercial laws⁹ which fosters a free economy while lending

⁹ These laws include the Uniform Commercial Code, the Uniform Consumer Credit Code, and consumer protection acts, among many others.

structure and certainty to commercial transactions. All of these things contribute to the ordered and civilized society of which the cases speak, benefitting direct marketers as well as local stores. Even without more, these services would be sufficient to justify the use-tax-collection duty.

In addition to such general benefits, state and local governments provide services that especially further the success of mail order firms. One service vital to direct marketers is local disposal of the vast quantities of catalogs and other paper that flood into their boundaries from distant mail order firms, evoking environmental concerns unrecognized at the time of *Bellas Hess*. These catalogs are time-sensitive and designed to be discarded; most are printed on slick, nonrecyclable paper. The quantities of paper involved are astronomical, as already demonstrated by the 91,000,000 catalogs, averaging 162 pages each, distributed by only one firm, Lands' End, in fiscal 1990. (See note 4 *supra*.) State and local trash disposal systems are greatly burdened by the task of handling this tremendous volume of waste paper.

The largest component of solid waste in this country is paper, comprising nearly 40% of the total.¹⁰ Of course, state and local governments must provide for the pick-up, treatment, and disposal of this garbage. In particular, concerns about long-term disposal of trash have multiplied in recent years, with the approaching obsolescence of many landfills and growing environmental concerns about incineration and the siting of new landfills. Almost every state in the country has recently enacted or is considering legislation addressing solid waste problems. State agencies are being reorganized and redirected to respond with increased vigor on solid waste disposal issues. These latter-day concerns contrast sharply with

¹⁰ See U.S. CONGRESS, OFFICE OF TECHNOLOGY ASSESSMENT, OTA-0-424, FACING AMERICA'S TRASH - WHAT NEXT FOR MUNICIPAL SOLID WASTE, Chap. 3 at 73-84 (Oct. 1989).

the notable lack of attention to waste management during the *Bellas Hess* era.¹¹

Mail order firms disingenuously argue that these garbage disposal services are of no benefit to them, that the services benefit only their customers in the several states. Such an argument is far too shortsighted and unrealistic for constitutional analysis under *Complete Auto*. In the first place, most catalogs come unsolicited and unwanted by the recipients, many of whom have never been customers of the sending mail order firm. Regardless of technicalities as to title, the catalogs are designed and transmitted for the profit-making purposes of the direct marketer.¹² It is of no significance whether the benefit is considered direct or indirect; even indirect benefits satisfy the *Commonwealth Edison* analysis. What is important is that the disposal of used catalogs places a significant burden on state and local services and, in any realistic view, greatly benefits multistate catalog retailers by facilitating the use of the catalogs on which they depend for business.

Another state-provided benefit crucial to direct marketers is the assurance of reliable telephone service through the extensive regulation of local telephone exchanges and their rates and the requirement of universal service.¹³ Indeed, the significance of this service to direct marketers has emerged since the days of *Bellas*

¹¹ *Id.*, Chap. 8 at 299-331.

¹² Mail order firms are "present" in their market states through the vast quantities of their catalogs. In *D.H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988), this Court held that states may impose use tax on the catalogs themselves, even when they are purchased by the retailer and shipped from out-of-state.

¹³ Through their utilities commissions, states pervasively regulate telephone service. See, e.g., CAL. CONST., Art. XII, § 3 and CAL. PUB. UTIL. CODE; TENN. CODE ANN., tit. 65, chaps. 4, 5, 21, 29; WASH. REV. CODE, tit. 80, chaps. 01, 04, 36.

Hess, because of the major technological changes in recent years.¹⁴ Electronic communication was not a factor in the *Bellas Hess* decision. Indeed, the Court expressly noted that *Bellas Hess* "ha[d] no telephone listing in Illinois . . . "¹⁵ Since that time the development and proliferation of "800" telephone numbers has transformed direct marketing, enabling distant firms inexpensively to maintain the equivalent of a local telephone listing in every exchange in the country and thus compete effectively with local retailers.¹⁶ For example, in California's litigation with Lands' End, the parties stipulated that Lands' End provides six hundred "800" telephone lines, involving no cost to any customer, available for orders 24 hours every day except Christmas. See note 4 *supra*. In Tennessee's *Bloomingdale's By Mail* case, see note 6 *supra*, discovery revealed that most of that firm's orders are taken over the telephone.

In addition to the great enhancement in the convenience and ease of placing orders, the "800" lines enable direct marketers to benefit from much the same personal contact with their customers as would occur at a local store. Moreover, this contact also makes compliance with local tax laws easier, by enabling the retailer to inform its

¹⁴ See *Goldberg*, 488 U.S. 252 (1989), discussed *supra* at 10, which recounts developments in electronic communications and discusses the adaptation of legal doctrines to those changes.

¹⁵ 386 U.S. at 754 (quoting opinion of Illinois Supreme Court, 34 Ill.2d 164, 166-67, 214 N.E.2d 755, 757 (1966)). Justice Stewart premised the *Bellas Hess* holding on the finding that the business of that company was carried out exclusively by mail or common carrier. 386 U.S. at 758.

¹⁶ Indeed, since many of the "800" telephone lines are available for orders 24 hours a day, direct marketers often are more convenient to their customers for the making of purchases than are local stores.

distant customer of the exact cost of his purchase, including sales and use taxes, virtually eliminating billing errors that might occur through mail transactions. All of these benefits to direct marketers depend on state regulation of local telephone service, and are fostered by state policies that promote inexpensive telephone service and a broad subscriber base. State agencies are playing ever-more important roles in regulating telecommunications now that the federal government is focusing on deregulation.¹⁷

Similarly, state regulation of financial institutions is essential to the success of direct marketing. Modern direct marketers depend heavily upon their customers' use of credit cards issued by in-state banks. The credit card system functions well in significant part because the states closely regulate banks and other financial institutions that issue those cards. Like "800" numbers, credit card networks have developed since the *Bellas Hess* decision. Together, these two advances, both significantly promoted by state regulation and policy, are principally responsible for the character of modern direct marketing, its tremendous success, and its transformation of retailing in America.

A high percentage of sales by credit card is the norm for mail order companies today.¹⁸ Eighty-six percent (86%) of Lands' End's sales are made through acceptance of a customer's credit card, according to the stipulation in the pending California case. See note 4 *supra*. In the California litigation with both Lands' End and the Direct

¹⁷ See P. TESKE, AFTER DIVESTITURE: THE POLITICAL ECONOMY OF STATE TELECOMMUNICATIONS REGULATION, p. xiii (1990).

¹⁸ In Tennessee's *Bloomingdale's* case, it was established that most purchases from that firm were made by credit card. See note 6 *supra*.

Marketing Association,¹⁹ those plaintiffs stipulated that a substantial portion of credit card sales to California customers involve cards issued by California financial institutions. Credit card merchant banks (to which direct marketers submit approved credit card charges for payment) provide those direct marketers with electronic equipment that enables the in-state bank that issued the credit card (or by another entity acting on behalf of that in-state bank) instantaneously to inform the retailer that it guarantees payment of the purchase. The direct marketer then provides the merchant bank with evidence that the transaction has been approved by or on behalf of the card-issuing institution, thereby ensuring that payment, at a discount, will be forthcoming to the direct marketer and shifting to the card-issuing institution the task of collecting the debt.²⁰ Moreover, the pervasiveness of national credit cards issued by local banks enables direct marketers to make sales on credit without developing their own cumbersome credit systems or becoming directly involved in debt collection, at enormous cost-saving benefit to the retailers. The precise nature of credit card transactions is set out in detail in the stipulation in California's DMA case. See Appendix C, at 27a-44a.

Multistate retailers also benefit from state efforts to foster a climate of consumer confidence. State consumer protection agencies and laws assure the public that businesses will deal fairly with them and that redress can be had for abuses. This is especially important to individuals who are purchasing goods sight-unseen from distant

¹⁹ *Direct Marketing Association v. Bennett*, No. CV-S-88-1067-MLS, E.D. Cal. (see Appendix at 28a-29a n.1).

²⁰ Obtaining credit card authorization ensures payment to the seller for the sale. As a result, the industry practice is to refuse sales for which electronic approval is not given. The mechanics of credit card transactions were detailed in *Colorado Springs National Bank v. United States*, 505 F.2d 1185 (10th Cir. 1974).

firms. Indeed, in many states a large proportion of consumer complaints handled by state agencies relate to out-of-state direct marketers.²¹ Reputable mail order firms benefit from consumer protection laws that target fly-by-night direct marketers and create a fair business environment for all participants. Additionally, state regulations such as consumer protection and usury laws apply to mail order transactions.²² It is clear that state courts can exercise personal jurisdiction over multistate firms that do business with their residents.²³ Of course, the availability of the state court system benefits direct marketers in many ways. While most such firms claim not to engage directly in debt collection, a bank or other entity must eventually be able to collect on credit purchases, and in doing so is dependent on state courts.²⁴ The ability of

²¹ Alabama and Missouri report that 20-25% of all consumer complaints involve out-of-state direct marketers. In New Mexico and Oregon, such complaints comprise the second largest volume of all reported complaints, next to automobile complaints and telephone marketers, respectively. Texas reports that mail order and catalog sales consistently rank approximately tenth among the thirty categories of most frequent consumer complaints.

²² See *State ex rel. Meierhenry v. Spiegel, Inc.*, 277 N.W.2d 298 (S.D.), appeal dismissed, 444 U.S. 804 (1979) (enforcement of state consumer protection laws); *Aldens, Inc. v. Miller*, 610 F.2d 538 (8th Cir. 1979), cert. denied, 446 U.S. 919 (1980) (application of market state's usury laws to out-of-state mail order retailer); *Aldens, Inc. v. Ryan*, 571 F.2d 1159 (10th Cir.), cert. denied, 439 U.S. 860 (1978) (same); *Aldens, Inc. v. LaFollette*, 552 F.2d 745 (7th Cir.), cert. denied, 434 U.S. 880 (1977) (same); *Aldens, Inc. v. Packel*, 524 F.2d 38 (3d Cir. 1975), cert. denied, 425 U.S. 943 (1976) (same).

²³ See *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

²⁴ The Federal Trade Commission requires suits instituted by mail order firms to be brought in the customer's home state. See *Spiegel, Inc. v. Federal Trade Commission*, 540 F.2d 287 (7th

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in-state purchasers to sue direct marketers in their state courts also increases the confidence of consumers in dealing with out-of-state companies.

Multistate direct marketers of every size thus enjoy a myriad of services provided by state and local governments. Indeed, absent the role of these governments, direct marketers would not be able to penetrate and saturate local markets as they have in recent years. Thus it is entirely appropriate, and consistent with the approach of *Complete Auto*, to require direct marketers to contribute to the local services from which they benefit. Compliance with the use-tax-collection duty²⁵ is a very minimal obligation to impose upon businesses that reap such great rewards from the states' marketplaces.

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Cir. 1976). In addition, when a purchaser tenders a check directly to a mail order firm, it would sue on that check in the courts of the purchaser's state.

²⁵Indeed, if the direct marketer dutifully collects the use taxes from its customers and remits them to the states, it will bear no separate obligation. Many states provide for vendors' compensation for sellers' collection efforts; such statutes allow vendors, including direct marketers, to retain a portion of the sales and use taxes that they collect on behalf of the state. See, e.g., FLA. STAT. ANN. § 212.12(1) (Supp. 1990); GA. CODE ANN. § 48-8-50; IDAHO CODE § 63-3619(c); IND. CODE ANN. § 6-2.5-6-10; KY. REV. STAT. ANN. § 139.570; MO. ANN. STAT. § 144.140 (1986); TENN. CODE ANN. § 67-6-509 (Supp. 1990); TEX. TAX CODE ANN. § 151.423-.424 (Vernon 1982).

IV.

ANY BURDENS OF THE USE-TAX-COLLECTION DUTY ON DIRECT MARKETERS ARE COMMENSURATE WITH THE BUSINESS THEY DERIVE FROM STATE MARKETS AND DO NOT SIGNIFICANTLY HINDER THEIR ACTIVITIES IN MULTIPLE JURISDICTIONS.

In the twenty-five years since the *Bellas Hess* decision, developments in computer technology have brought about the greatest revolution in compiling, transmitting, and using information since the invention of written language. The same computer capabilities that in recent years have enabled direct marketers to target potential customers, refine mailing lists, utilize customer purchasing histories, and process orders, invoices, and payments, also enable them to comply easily with the use tax laws of the jurisdictions into which they choose to send their solicitations and merchandise.²⁶ Therefore, even assuming that examination of burdens placed on direct marketers by the use-tax-collection duty is at all relevant under the *Complete Auto* analysis, such burdens are constitutionally insignificant.

The modern realities of business belie direct marketers' assertions that tax compliance in numerous jurisdictions would be well-nigh impossible. Many conventional retailers have administratively distinct mail order divisions but have complied with use-tax-collection duties in all jurisdictions for many years, pursuant to this Court's decisions in *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, rehearing denied, 312 U.S. 715 (1941), and *Nelson v. Montgomery Ward*, 312 U.S. 373, rehearing denied,

²⁶See Westphal, *The Computer's Role in Simplifying Compliance with State and Local Taxation*, 39 VAND. L. REV. 1097 (1986).

312 U.S. 716 (1941). In practice, their difficulties in compliance are identical with those that Quill and others would face, since the mail order business of these firms is distinct from their retail outlets. Nonetheless, this Court held in *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977), that the use-tax-collection duty can be imposed even when the in-state operations that give rise to that duty are unrelated to the making of sales. The lamentations of Quill and other direct marketers about the difficulties of compliance are unfounded in light of modern technological advances, and amount to no more than an effort to evade their fair share of state and local responsibilities and to ensure their continued unfair advantage over local retailers who do collect the taxes.²⁷

Petitioner and its amici complain that 6,500 local jurisdictions levy use taxes at differing rates, and that compliance would create virtually an insurmountable burden for out-of-state companies. This argument grossly distorts reality. In truth, many states, like North Dakota and Connecticut, authorize no local sales and use taxes at all. Of those states that do, the vast majority provide for centralized administration of all taxes by the state taxing authority. In fact, the Direct Marketing Association's own figures reveal that, of the 46 states in which sales and use taxes are imposed, at least 40 states require only one return to be filed to cover all the taxing jurisdictions

²⁷ Indeed, many direct marketers simply instruct the customer to enter the appropriate state and local taxes on the order form. While a few customers may calculate the tax incorrectly (just as they may calculate prices or delivery charges incorrectly), substantial compliance is effectuated. Since most orders today are made and accepted over the telephone, most calculations are made by the direct marketer itself. Any quibbling that may occur over accounting details is far too trivial to affect the constitutional scope of the states' taxing power.

within that state. See *amicus* brief of Direct Marketing Association, Appendix 3. Some states provide for a uniform statewide rate for out-of-state vendors, see, e.g., CAL. REV. & TAX CODE § 6203(j), while others offer out-of-state vendors the option of a uniform rate. See TENN. CODE ANN. § 67-6-702(f); Wash. Admin. Code, Rule 458-20-221(5).

Similarly, the petitioner's complaint of a myriad of exemptions is a mere red herring. In practice, exemptions are established by statutes of statewide applicability, making the number of variations quite small. The administrative landscape is thus quite different from the one painted by the petitioner.

In fact, for companies like the petitioner, whose very ability to compete successfully on a national basis has been made possible by sophisticated computer programs and capabilities, the cry of administrative compliance burdens is disingenuous to say the least. Evidence in the Tennessee litigation established that readily available computer programs already exist that can easily and quickly calculate the tax rate for every jurisdiction, large and small, throughout the United States, taking account of exceptions and peculiarities of each jurisdiction, and at the same time preparing returns for filing in compliance with both state and local requirements. As one computer expert has stated, existing computers and software are "specially suited for use by companies whose business reaches into a multitude of state and local taxing jurisdictions."²⁸ Furthermore, the necessary software is available at a cost of only \$12,000 for initial purchase plus \$10,000 per year for servicing and monthly updates, and is compatible with all major brands of computers, including

²⁸ Affidavit of Ray Westphal, ¶ 4, Record at 193, in *Bloomingdales' By Mail Ltd. v. Huddleston* (see note 6 *supra*), reproduced herein as Appendix D at 45a-62a. Currently this software contains data for over 50,000 locations. (Record at 196, Exh. A at p. 3; Appendix at 51a).

personal computers.²⁹ The direct marketers' lament that only large companies that can afford mainframe computers can benefit from this technology is simply untrue.

Thus, the collection of use taxes is not unduly burdensome, as the petitioner claims. Rather, it is just another cost of doing business, no more expensive or cumbersome than all the other administrative and logistical necessities associated with doing business on a multi-state basis, and certainly not disproportionate to the benefits direct marketers receive. Nor is it greater than the burdens local businesses bear when one considers their liability for property, excise, business, employment, payroll, and other taxes.

Since *Bellas Hess*, this Court has not restrained state taxing jurisdiction because of compliance concerns so long as the tax is nondiscriminatory and fairly apportioned.³⁰ As the Court determined in *Complete Auto*, "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business." 430 U.S. at 288 (quoting *Western Live Stock*, 303 U.S. at 254). The principle that "interstate commerce may be made to pay its way" not only acts as a limit on Commerce Clause restrictions imposed on the states; it is itself an affirmative, constitutionally rooted protection of the states, implicit in the commitment of our constitutional structure to a federal system that protects traditional state powers, including the power to tax those who exploit state protections.

Quill and other direct marketers claim that their operations should not be burdened by the regulatory and taxing powers of the states toward which they purposefully direct their efforts and from which they derive

²⁹ *Id.*, Record at 192, Appendix at 48a.

³⁰ See Rothfeld, *supra*, at 9.

their business and profit. This assertion is a thinly-disguised attempt to breathe new life into the discredited doctrine that exclusively interstate commerce should be beyond the taxing jurisdiction of the states. That doctrine, which provided the foundation for the *Bellas Hess* decision, has been thoroughly and properly rejected in *Complete Auto* and subsequent cases, and there is no sound reason to revive it now.³¹

³¹ The Direct Marketing Association, at pages 6-7 of its *amicus* brief, wholly mischaracterizes the position of Professor Paul J. Hartman in stating that he advocates only a legislative overruling of *Bellas Hess*. As Professor Hartman has made very clear in his extensive writings on this issue, he believes *Bellas Hess* was wrongly decided even in 1967 and that its holding cannot be reconciled with the *Complete Auto* test. While he believes that congressional action could be helpful in this area, he prefers it to occur against a backdrop of judicial recognition of the states' powers to tax and regulate catalog firms that purposefully avail themselves of state marketplaces. As Professor Hartman stated quite vividly in one of his articles, "the Supreme Court could – and should – relegate the *Bellas Hess* decision to the dustbin of unconstitutional oblivion." Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 VAND. L. REV. at 1008 (1986); P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION 618-37 (1981).

CONCLUSION

For these reasons, Connecticut, Tennessee, California, and the other *amici* states urge that the decision of the Supreme Court of North Dakota be affirmed.

Respectfully submitted,

December 26, 1991

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No. 91-194

In The
Supreme Court of the United States
October Term, 1991

QUILL CORPORATION,

Petitioner,

v.

STATE OF NORTH DAKOTA,
BY AND THROUGH ITS TAX COMMISSIONER,
HEIDI HEITKAMP,

Respondent.

**On Writ Of Certiorari To The
Supreme Court Of North Dakota**

**APPENDIX TO BRIEF OF THE STATES OF
CONNECTICUT, TENNESSEE, CALIFORNIA,
ARKANSAS, FLORIDA, GEORGIA, IDAHO,
ILLINOIS, IOWA, KENTUCKY, LOUISIANA,
MARYLAND, MASSACHUSETTS, MICHIGAN,
MISSISSIPPI, NEVADA, NEW YORK, OHIO,
OKLAHOMA, PENNSYLVANIA, SOUTH CAROLINA,
TEXAS, UTAH, VERMONT, VIRGINIA,
WASHINGTON, WEST VIRGINIA AND THE
DISTRICT OF COLUMBIA AS AMICI CURIAE,
IN SUPPORT OF RESPONDENT**

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APPENDIX B -

Affidavit of Holley H. Ulbrich, Ph.D., and Exhibit B thereto, filed on January 16, 1991 in *Bloomingdale's By Mail Ltd. v. Joe B. Huddleston, Commissioner of Revenue, and Charles W. Burson, Attorney General of Tennessee*, in the Chancery Court for the 20th Judicial District of Tennessee, Davidson County, No. 89-3017-II 3a

APPENDIX C -

Stipulations dated May 24, 1991, submitted in *Direct Marketing Association, Inc. v. William M. Bennett, et al.*, in the United States District Court for the Eastern District of California, No. CIV S-88-1067 MLS-EM 27a

APPENDIX D -

Affidavit of Ray Westphal and Exhibit A thereto, filed on January 16, 1991 in *Bloomingdale's By Mail Ltd. v. Joe B. Huddleston, Commissioner of Revenue, and Charles W. Burson, Attorney General of Tennessee*, in the Chancery Court for the 20th Judicial District of Tennessee, Davidson County, No. 89-3017-II 45a

APPENDIX A

State Sales and Use Tax statutes regarding direct marketing:

- Ariz. Rev. Stat. Ann. § 42-1401(5)(b) (1991)
- Ark. Stat. Ann. § 26-53-121(b) (Supp. 1989)
- Calif. Rev. & Tax Code Ann. § 6203(f) (West Supp. 1991)
- Conn. Gen. Stat. §§ 12-407(12)(g) and (15)(e) (West Supp. 1990)
- Fla. Stat. § 212.0596(2)(e) (Supp. 1990)
- Ga. Code Ann. § 48-8-2(3)(H) (Supp. 1991)
- Idaho Code § 63-3611(g) (1989)
- Ill. Rev. Stat. ch. 120, para. 439.2(4) (Supp. 1990)
- Iowa Code Ann. § 422.43(12)(b) (West 1990)
- Kan. Stat. Ann. § 79-3702(h)(2) (Supp. 1990)
- Ky. Rev. Stat. § 139.340(2)(c) (Michie/Bobbs-Merrill 1991)
- La. Rev. Stat. Ann. § 47:301(4)(1) (West Supp. 1990)
- Mass. Ann. Laws ch. 64H § 1 (Law. Co-op. 1991)
- Minn. Stat. Ann. § 297A.21, subdiv. 4(a) (West Supp. 1991)
- Miss. Code Ann. § 27-67-3(j) (Supp. 1989)
- Mo. Ann. Stat. § 144.605(2)(a) (Vernon Supp. 1991)
- Neb. Rev. Stat. § 77-2702(21)(e) (1990)
- Nev. Rev. Stat. Ann. § 372.728(6) (1989)
- N.C. Gen. Stat. § 105-164.8(b)(5) (1989)
- N.D. Cent. Code § 57-40.2-01(6) (1991)
- N.J. Stat. Ann. § 54:32-2(i)(1)(C) (West 1991)
- N.M. Stat. § 7-9-10(A) (1990)
- Ohio Rev. Code Ann. § 5741.01(H) and (3) (Anderson Supp. 1990)
- Okla. Stat. Ann. tit. 68, § 1354.1.5 (West Supp. 1990)
- Pa. Stat. Ann. tit. 72, § 7201(b)(3) (Purdon 1990)

R.I. Gen. Laws §§ 44-18-15(1)(E) and -23(c)
 (Supp. 1990)
 S.C. Code Ann. § 12-36-70(2)(b) (Law. Co-op.
 Supp. 1990)
 Tenn. Code Ann. § 67-6-102(6)(J) (1989)
 Tex. Tax Code Ann. § 151.107(a)(5) (Vernon
 Supp. 1991)
 Utah Code Ann. §§ 59-12-102(9)(c) and (17)(b)
 (Michie Supp. 1991)
 Va. Code Ann. § 58.1-612(b)(6) (1991)
 Vt. Stat. Ann. tit. 32, § 9701(9)(F) (Supp. 1990)
 Wash. Rev. Code Ann. § 82.12.040 (Supp. 1991)
 W. Va. Code § 11-15A-6a(a)(3) (Supp. 1991)

APPENDIX B
IN THE CHANCERY COURT
FOR THE STATE OF TENNESSEE
20TH JUDICIAL DISTRICT, DAVIDSON COUNTY

BLOOMINGDALE'S BY MAIL	:	
LTD.,	:	
Plaintiff,	:	
v.	:	
JOE B. HUDDLESTON, Commissioner of Revenue, and CHARLES W. BURSON, Attorney General of Tennessee,	:	No. 89-3017-II
Defendants.	:	

AFFIDAVIT OF HOLLEY H. ULRICH, PH.D.

STATE OF SOUTH CAROLINA)
)
 COUNTY OF PICKENS)

HOLLEY H. ULRICH, Ph.D., after being duly sworn
 in accordance with the law, makes oath as follows:

1. I am a Professor of Economics at Clemson University in Clemson, South Carolina. I received my doctorate in economics from the University of Connecticut in 1968. My educational attainments, work experience, and descriptions of my published works are set forth in the attached true copy of my resume (Exhibit A), which I hereby incorporate as part of this sworn statement.

2. During 1984 and 1985, while on sabbatical from my professorship at Clemson University, I served as Senior Policy Analyst for the United States Advisory Commission on Intergovernmental Relations (ACIR), in Washington, D.C. The ACIR is a permanent national bipartisan body created by Congress to monitor and recommend improvements in the operation of the American federal system and the interrelationships of the federal, state, and local governments. The ACIR is composed of representatives of the executive and legislative branches of federal, state, and local governments, and of the public.

3. In my capacity as Senior Policy Analyst for the ACIR, I conducted research studies pertaining to the interstate mail order sales industry, and prepared the ACIR's report, *State and Local Taxation of Out-of-State Mail Order Sales*, which was published in April 1986, and the update of that report, *Estimates of Revenue Potential from State Taxation of Out-of-State Mail Order Sales*, published in September 1987.

4. In the course of my research on behalf of the ACIR and in the time since then, I have become knowledgeable of and have continued to monitor the nature, operations, and growth of the interstate mail order sales industry. Likewise, I am familiar with and knowledgeable of the scholarly literature, research studies, trade publications, official governmental studies and statistical compilations, and other resources, which are reasonably relied upon by experts in the fields of economics, public finance and taxation, in analyzing and forming educated conclusions regarding the interstate mail order sales industry, and the retail sales industry in general.

5. I have recently authored an unpublished paper, entitled "Changes in the Mail Order Industry Since 1967," which is attached to this affidavit as Exhibit B, and which I hereby incorporate as part of this sworn statement. That paper sets forth opinions and conclusions regarding the mail order industry which I have formed as a result of my research and within my expertise as an economist and a specialist in state and local public finance. The opinions and conclusions which I set forth in that paper are based upon sources, many of which are discussed or cited, which are among the sources of information reasonably relied upon by experts in the fields of economics, public finance and taxation in forming opinions or inferences regarding the interstate mail order sales industry.

/s/ Holley H. Ulbrich
HOLLEY H. ULRICH, PH.D.

Sworn to and subscribed before me, this 10th day of January, 1991.

/s/ Ssybil C. Miller
NOTARY PUBLIC

My Commission expires:

7/20/98

EXHIBIT B

**CHANGES IN THE
MAIL ORDER INDUSTRY SINCE 1967**

Holley H. Ulbrich
 Alumni Professor of Economics
 Clemson University
 Clemson, SC

The author, a specialist in state and local public finance, holds a Ph.D. in economics from the University of Connecticut (1968). She served as a Senior Policy Analyst at the U.S. Advisory Commission on Intergovernmental Relations in Washington D.C. in 1984-85. In that capacity she authored the Commission's report, *State and Local Taxation of Interstate Mail Order Sales* (A-105), published in April 1986. Dr. Ulbrich is also a Senior Fellow at the Strom Thurmond Institute of Government and Public Affairs at Clemson University, working in applied public policy areas on issues of state and regional interest.

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INTRODUCTION

Since 1967, the mail order industry has grown and changed in significant ways – in size, in sales, in technology, and in marketing techniques. Many of the changes imply that the industry is fundamentally different in both size and method of operation from the mail order industry of 1967.

Industry Growth

Measuring both the size and the growth of the mail order industry is a difficult task, because mail order sales are scattered among a number of sellers, many of whom are only partially mail order firms. The lower limit on the

size of the industry is given by the Department of Commerce's *Census of Retail Trade*, conducted at five year intervals. These data only cover firms which are exclusively or primarily mail order, and thus fail to pick up sales or establishment data for other firms that sell by mail order in addition to other outlets. Far larger estimates come from industry sources, which identify all mail order sellers, not just those that fit the narrow Census definitions. The range of estimates of the size of the industry is thus from 1+ percent of retail sales to as much as 10 percent.

By any of these measures, the mail order industry has grown substantially since 1967, both absolutely and relative to retail trade in general. Over 7 billion catalogs are mailed each year to U.S. households, in addition to other methods of marketing that result in shipment of goods to customers without direct face-to-face contact between seller and buyer - the hallmark of mail order selling. More concrete indicators of growth in mail order sales can be found both from official government sources and from trade publications.

Government data: the Census

While the Census data clearly measure only a part of the industry, they do provide the best baseline measure of industry growth since 1967. These data are published in the Department of Commerce's *Census of Retail Trade* at five year intervals. The Standard Industrial Classification (SIC) code for mail order firms is 5961. The most recent retail trade census was conducted in 1987, showing 7,227 mail order firms in the category 5961 with over \$20

billion in sales. Figure 1 uses Census data to show the growth of the number of firms in the mail order category. Figure 2 shows the growth in sales in mail order (5961) firms and in retail firms in general. Between 1967 and 1987, Census data record an increase in mail order sales from 1 percent to about 1.3 percent of total retail sales. During the same period, mail order sales grew at an average rate of just under 10% a year, compared to 8.4% for retail sales in general. Except for a drop in the number of mail order firms between 1982 and 1987, every Census measure shows that growth of the mail order business has outpaced the growth of the retail industry.¹

Census data, however, captures only a small part of the mail order business. The firms reported in the *Census of Retail Trade* are only those for whom the primary retail activity is mail order. Increasingly, other retailers have a sideline in mail order which is not captured in the 5961 classification. Instead, sales of these firms are counted in their primary classification, which may be as a department store, a specialty shop, or some other classification. Estimates by the Small Business Administration and others suggest that the Census data for SIC 5961 are capturing substantially less than half of actual retail mail order sales.² In addition, a significant volume of mail order sales are to business firms rather than to retail customers. Depending on the item, the purchaser, and the state sales tax law, a substantial portion of these mail order sales to business firms may also consist of items subject to state and local sales and use taxes.

Trade Data: Industry Periodicals

Trade journals and publications describe an industry that has expanded at a rapid rate over the last twenty years and can be expected to continue to grow and thrive in the 1990s. The principal trade journal of the mail order industry is the magazine, *Direct Marketing*, although other trade publications also cover both mail order and direct marketing. According to *Direct Marketing*, some segments of the direct marketing business, particularly fund-raising, did experience a downturn in 1989, with the annual growth in the dollar volume dropping from the average of about 10% a year to only 5% between 1988 and 1989.³ The slowdown, however, did not affect mail order, which experienced growth in the 6-10% range across the various segments of the industry. Mail order did an especially good Christmas business in 1989, with growth of 12% for the season over the previous year (compared to 5-6% for retail sales in general).⁴

Direct Marketing's Arnold Fishman, a noted authority on the measurement of the mail order industry, estimated total mail order sales at \$183 billion in 1989, of which consumer mail order purchases accounted for \$87 billion. Of that amount, \$54 billion was for products (generally subject to sales tax) and \$33 billion was for services (less likely to be subject to sales taxes in most states). The remaining \$96 billion consisted of business purchase (\$50 billion) and charitable business, primarily solicitations (\$46 billion).⁵ The consumer figure of \$87 billion would represent about 5% of estimated 1989 retail sales of \$1.7 trillion. Even this figure understates the size of the mail order industry, because it does not include any mail order sales to business purchasers. Adding mail order sales to

business purchasers would increase the share of mail order in total final sales to about 8 percent. While a large share of consumer purchases by mail consists of items normally subject to sales taxes, the amount of business purchases that are subject to sales taxes varies greatly from state to state. In most states, however, at least part of these business purchases would be taxable.

Even these data understate the significance of the mail order industry for particular segments of the market. In some product lines, the market share is much higher. In 1983, twenty percent of magazine sales were by mail order, 9 percent of book sales, and 8 percent of apparel sales.⁶ These sales represented significant competition for local retailers such as bookstores, newsstands, and department and specialty apparel shops.

Despite the documented presence of large, growing, and profitable mail order businesses such as Land's End, L.L. Bean, Fingerhut and Williams-Sonoma, mail order still has a Mom and Pop image. This image has helped to fuel resistance to requiring these firms to collect and remit sales taxes in all the states in which they have customers (subject, perhaps, to a sales threshold). In fact, there are numerous large mail order firms, including those that offer mail order services a sideline. The top 250 firms showed mail order sales ranging from 41 million (CUMIS Insurance Society) to over \$3 billion (J.C. Penney). Seventy percent (175) of the top 250 mail order firms sell a significant amount of products or services that are generally subject to state and local sales taxes in most states with sales taxes.⁷ Many of them do not meet the physical presence test and thus are able to avoid

collecting and remitting sales taxes to most of the states in which they do business.

Composition of Industry Growth

According to *Direct Marketing*, four of the top ten mail order firms are still traditional catalog sellers. These four are J.C. Penney; Sears, Roebuck; Spiegel (Otto Versand); and Fingerhut (Primerica). The first two firms, with annual mail order sales of more than \$4.6 billion, have outlets in most states and collect sales taxes across the country. The other two have fewer outlets, collecting sales taxes in some states and not in others on a combined sales revenue of about \$2.3 billion. Two others among the top ten (GEICO and U.S. Services Automobile Association) sell insurance, not generally subject to sales tax. Among the others are Time-Warner, Readers Digest, Newhouse, and Associated Communications, all in the publications/broadcast area.⁸

Two major home shopping networks fall in the second ten, QVC Network and Home Shopping Network – a method of selling unknown in 1967. Campeau, May Department Stores and Macy's are the top department store mail order firms, with combined mail order sales of more than \$1.8 billion in 1989.⁹ Most department stores only collect and remit sales taxes to states where they have retail outlets or other physical presence. Thus, there is considerable potential for additional sales and use tax collections among at least some of the major mail order sellers.

Reasons for Industry Growth

The fact that mail order sales have been growing more rapidly than retail sales in general reflects the fact that the industry enjoys some particular advantages in retailing in the 1980s and 1990s. While the purely mail order firm, unlike a traditional retailer, does not incur the cost of retail space and sales staff, there are other costs of operation, including catalogs and advertising expenditures, order clerks, warehouses, and shipping costs. Cost advantages, therefore, which have existed from the time of some of the earlier mail order firms in the 19th century, are inadequate to explain the recent surge in this part of the retail industry.

Some of the factors contributing to the last two decades of mail order growth were anticipated by Lester Wunderman in *Advertising Age* in 1967. Wunderman foresaw some changes in both the technology of marketing (telephone sales and the use of computers) and the demographics (working women in particular) that would contribute to the growth of mail order and its parent industry, direct marketing.¹⁰ His predictions have been validated. Among the important non-technological contributing factors to growth in mail order sales in recent years have been changing demographics, specialty/niche marketing, and the decline of small town Main Street retailers. These changes have enabled mail order firms to compete more effectively against in-state retailers. In addition, for some customers the fact that they do not have to pay sales tax may be a factor in choosing mail order over an in-state retailer.

Demographic changes

In general, in-home shoppers are above average in socio-economic status (income, education, occupation, and social class.¹¹ Women are particularly likely to shop at home. The demographic changes in the U.S. population of the last few decades tend to favor the mail order segment of the retail industry. Many mail order sellers target older persons and two-earner couples because of the convenience and time-saving characteristics of shopping at home, and both of these groups have increased faster than the population as a whole.

The percentage of the population over age 65 has increased steadily from 9.6% in 1967 to 12.2% in 1987. As the baby boom ages, the population will become increasingly mature. Older customers are a relatively affluent group; in 1986, persons aged 50 and older accounted for 25% of the population but an estimated 75% of discretionary income.¹² In addition, those older persons who have limited mobility often find catalog shopping the most feasible alternative. Thus, this age group has become an important target for mail order firms.

A second group of customers of growing importance are the adults in two-earner families, particularly wives, who are likely to take on a large share of the shopping duties. In 1967, only 41% of adult women worked outside the home, but by 1989, 57% of adult women were in the labor force. Two-earner couples find that their limited time at home can be made to do double duty by combining shopping time with family time without leaving the home. At the same time, like the over-50 population, two-

earner families tend to be attractive customers because they have more discretionary income.

Specialty selling/niche marketing

A second source of industry growth has been the development of specialty catalogs and niche marketing, which allows a firm to access customers with particular characteristics all across the country. A firm specializing in doll house furniture or harmonica music, for example, would only be able to survive as a traditional retailer in a very large urban area. As a specialty catalog seller, however, such a firm can put together a sufficiently large national or even global clientele to make the business profitable.

Niches also mean identifying other kinds of target groups besides purchasers of highly specialized products. One of the growth areas in the last few years, for example, has been corporate gift-giving. Corporate representatives can select from a catalog by mail or telephone and have gifts delivered to customers or suppliers as a goodwill gesture.¹³ This niche approach identifies customers by a particular kind or season of buying activity while offering a broad range of products to service that need. Mail order firms now have capability, using computer data banks, to target the retired, teenagers, college students, and working mothers. Computers allow sellers to put together specialized mailing lists as well as specialized catalogs for a range of products to meet a defined market segment's particular needs or tastes.

The decline of Main Street

One of the most visible trends in retail marketing across the nations since 1967 has been the displacement of small local retailers by shopping malls and large discount houses located in or near larger urban centers. Towns of less than 5,000 population are often limited to a gas station, a convenience store or two, a drug store, and a few other local retailers. Some even lack fast food outlets or basic grocery stores. Main Streets in smaller towns are full of empty storefronts, while shoppers congregate at malls and at the discount chains that build only in larger towns and cities.¹⁴

While the decline of Main Street has been a source of frustration to local citizens and community leaders, it has been a boon to the catalog seller. Shopping by phone at home with a quick turnaround is often more convenient for the small town resident than a long trip to the nearest major shopping area. Mail order was probably not a significant contributor to the decline of small town shopping, but it was well-poised to take advantage of the opportunity created by the loss of local shops. Ironically, mail order is returning to its rural routes while continuing to enjoy substantial sales to its new-found upscale urban and suburban clientele.

Marketing Technology and Industry Growth

Technological changes have revolutionized retail business in general, but some of the innovations that took place in the last decade have particularly favored the growth of the mail order industry. In fact, the term mail order is an obsolete description of the industry, since

a relatively small share of orders are now being placed and/or delivered by mail. Telephone is the most common way to order, with FAX machines an up-and-coming alternative. While many deliveries still take place through the U.S. Postal Service, competitors such as United Parcel Service are also claiming a large share of the shipping.

Widespread use of telemarketing, television shopping programs, and toll-free 800 numbers make it possible for a retailer to be meaningfully present in all 50 states with a physical location in only one of them. Physical presence is a concept derived from a more traditional view of retail selling methods. In addition, other innovations such as FAX machines, widespread use of computers, and credit cards, all of which came into general use since 1967, have simplified shopping at home and favored mail order over traditional retailers.

Telemarketing

Telemarketing was almost unknown in 1967, but is a regular intrusion into the daily lives of most American households in the 1990s. While a large part of telemarketing is aimed at fund-raising for various charitable and political causes, there is a significant amount of direct selling that is undertaken in this way.

Rarely does the telemarketer operate from within the state where the call is placed. National phone banks manage the solicitations, so most telemarketers are never physically present in their customer's state.

Television Shopping

With the spread of cable television, home shopping programs have become increasingly popular. Although this method of shopping is undoubtedly remote from what the Supreme Court contemplated in 1967, it represents a growing share of the market. Like telemarketing, with television shopping the TV retailer rarely has a physical presence in the state wherein the customer resides.

The Home Shopping Network was a pioneer, and remains among the top twenty mail order firms, but this industry leader was overtaken in 1989 by the QVC Network. In that year QVC saw a 135 percent increase in sales, from \$193 to \$453 million. QVC alone claims a base of 4.5 million customers, with an average order of \$40 to \$50 and more than half of them repeat customers. Thus, the volume of sales through cable shopping networks is substantial and growing.¹⁵ Still on the horizon is home videotex, which marries telephone fiber optics transmissions to the TV set to allow viewers to examine merchandise at home and place their orders.¹⁶

800 Numbers

The rapid expansion in the use of 800 numbers in the last decade has removed a major barrier to mail order. Customers who did not want to bother filling out an order form but also did not want to pay for a long-distance call now can call toll-free, often 24 hours a day, to place their orders. Again, use of the 800 number may not create any physical presence by the seller in the customer's state. Along with telemarketing and television shopping, the use of toll-free 800 numbers means that a

seller no longer needs physical proximity to customers in order to make a sale.

Fax Machines

The FAX machine appeared rather suddenly as an effective means of visual communication to replace both overnight mail delivery service and oral communication by telephone. A FAX machine is faster and cheaper than overnight delivery services and can transmit more complex visual messages than can be conveyed by oral communication.

Telemarketers have been quick to take advantage of the FAX machine as a way of transmitting promotional information, and many of them are equipped to accept orders by FAX. This technological boon to the mail order industry is still in its infancy and can be expected to see expanded use in the next few years.

Credit Cards

The widespread use of bank credit cards has taken place largely since the late 1960s. In 1987, about 40 percent of U.S households had at least one bank credit card,¹⁷ and many have multiple cards. There may have been some growth in the number of households with credit cards in the last few years because of extensive promotional efforts by banks to expand the number of cardholders. While credit cards have been a boon to retailing generally, they have probably done more to encourage mail order. Credit cards greatly simplify the process of ordering by mail or telephone because the

customer no longer has to make all the computations, including shipping costs and sales taxes, and remit precisely the right sum. Credit cards also simplify the process of returning or exchanging merchandise by crediting the buyer's account. In some cases, the credit card number, as well as other relevant information, can be transmitted by punching the digits on a touchtone telephone.

Credit card issuers have been quick to take advantage of this captive market and use their billings as well as telemarketing to encourage cardholders to purchase merchandise and services by phone or mail. Typically a credit card bill will contain one or more offerings of merchandise as retailers team up with credit card issuers (or, in the case of Sears or Penney's, take advantage of their own credit program) to solicit additional sales.

Computers

The popularity of microcomputers both at home and in business has had particularly important implications for the mail order industry. In 1967, computers were still very large, clumsy, and expensive. By 1980 the first microcomputers were appearing in offices and even homes, and within a decade the U.S. had a large computer-literate population with access to computers at home, work, and school.

In mail order, the computer allows the person taking the order to offer the same personal touch as one's regular retail clerk. The computer will undoubtedly have the customer's name, address, telephone number, account number, and charge card information ready in response

to a call. It may also store sizes, color preferences, and other ordering history information that allows the order clerk to suggest related or substitute items. Although computers are criticized as impersonal, they are uniquely suited to adding a personalized touch to mail order purchases.

A second important role that computers have played in promoting mail order sales is the development of specialized mailing lists that allow a firm to select catalog recipients on the basis of a number of characteristics – age, family size, children, pets, hobbies, occupation, income levels, political preference, and other factors that may correlate highly with the firm's profile of most likely customers. The availability of such specialized computer lists has greatly facilitated the expansion of specialty mail order marketing in the last decade. Computers have contributed more than any other single factor to the growth of specialty mail order firms and specialized mailing lists targeting likely buyers.

Finally, the home computer has become a part of the shopping network for many households, who order through a modem from such data-based operators as Dow-Jones, Compu-Serve, or Compu-U-Card. In 1987, Compu-U-Card alone had 125,000 subscribers, of whom 75,000 used the service to shop by computer.¹⁸

Projections for the 1990s

Since 1967, the growth of mail order and its parent, direct marketing, has consistently exceeded the growth of retail sales. Existing firms have expanded, new and specialized firms have entered the market, and established

retailers have added mail order activity as a way to broaden their market base. Both past experience (using Census data) and the industry's own projections for the next decade are upbeat.

Fifty percent of Americans purchase by mail or phone at least once a year.¹⁹ As the baby-boomers hit the 50 mark beginning in the mid-1990s, that share can be expected to increase. New technologies, such as the video airport shopping kiosk²⁰, can be expected to continue to emerge, as well as expanded use of the new technologies of the 1980s. Videotex in the home is still in its infancy in the U.S., although it has caught on in France with some 5 million subscribers to the multi-function Minitel service. In this country, home videotex should be a significant factor in expanding in-home sales by the end of the decade.²¹ These technological changes have made retailing far more of a national industry and less of a localized industry than it has been in the past. Changes in technology in particular suggest that what constitutes meaningful presence in the state in 1990 is very different from what it was in 1967.

With the continuing spread of computers, FAX machines, niche marketing, cable shopping networks, 800 numbers, credit cards, and other innovations favorable to the mail order industry, as well as growth in those population segments most interested in mail order, it is reasonable to expect mail order sales will continue to experience (if not increase) the annual growth rate of dollar volume of sales of about 10% a year that was the average over the last two decades. New technology means that the mail order firm increasingly represents a very direct competitor to the local retailer. If mail order continues to make

inroads on the total retail market, the potential sales tax revenue from presently untaxed mail order sales will represent an increasingly significant revenue loss to state and local governments.

FOOTNOTES

¹ U.S. Department of Commerce, *Census of Retail Trade*, 1963, 1967, 1972, 1977, 1982, 1987.

² U.S. Advisory Commission on Intergovernmental Relations, *State and Local Taxation of Out-of-State Mail Order Sales* (A-105), April 1986, p.3.

³ Fishman, Arnold. "1989 Mail Order Overview," *Direct Marketing*, September 1990, p. 41-44.

⁴ Halverson, Guy. "Mail Order Retailers Poised for Growth," *The Christian Science Monitor*, March 26, 1990, p. 9.

⁵ Fishman, Arnold. *Guide to Mail Order Sales 1989*. Hoke Publications, Deerfield, IL. An abbreviated summary of the findings in this annual publication is given in "Mail Order Top 250," *Direct Marketing*. July 1990, p. 27-45.

⁶ Fishman, Arnold. *Guide to Mail Order Sales 1983*. Hoke Publications, Deerfield, IL.

⁷ *Ibid.*

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ Wunderman, Lester. "Mail Order - the Coming Revolution in Marketing," *Advertising Age*. July 24, 1967, p. 67-70.

¹¹ Gillett, Peter L. "In-Home Shoppers - an Overview," *Journal of Marketing*. October 1976, p. 81-84.

¹² Halverson, *op. cit.*

¹³ *Ibid.*

¹⁴ Rawn, Cynthia Dunn. "WalMart vs. Main Street," *American Demographics*, June 1990, p. 58-9, offers an illustration of the decline of Main Street, looking at the impact of discounters on small town shops. A more general view of the problems of

traditional small town business districts is provided in "Malaise on Main Street," *Wall Street Journal*, August 2, 1990, p. 1

¹⁵ "Mail Order Top 250" (*op. cit.*).

¹⁶ Cutler, Blayne. "The Fifth Medium," *American Demographics*, June 1990, p. 25-30.

¹⁷ "Bankcards at the crossroads," *ABA Banking Journal*, September 1987, p. 66-79.

¹⁸ Barmash, Isadore. "Armchair buying is a growth industry." *the New York Times*, February 19, 1987.

¹⁹ Halverson, *op. cit.*

²⁰ Haber, Holly. "Upscale shopping kiosks go online in U.S. airports." *Women's Wear Daily*, November 21, 1988, p. 6.

²¹ Cutler, *op. cit.*

Mail Order Establishments, 1963-1987

Primary Mail Order Only

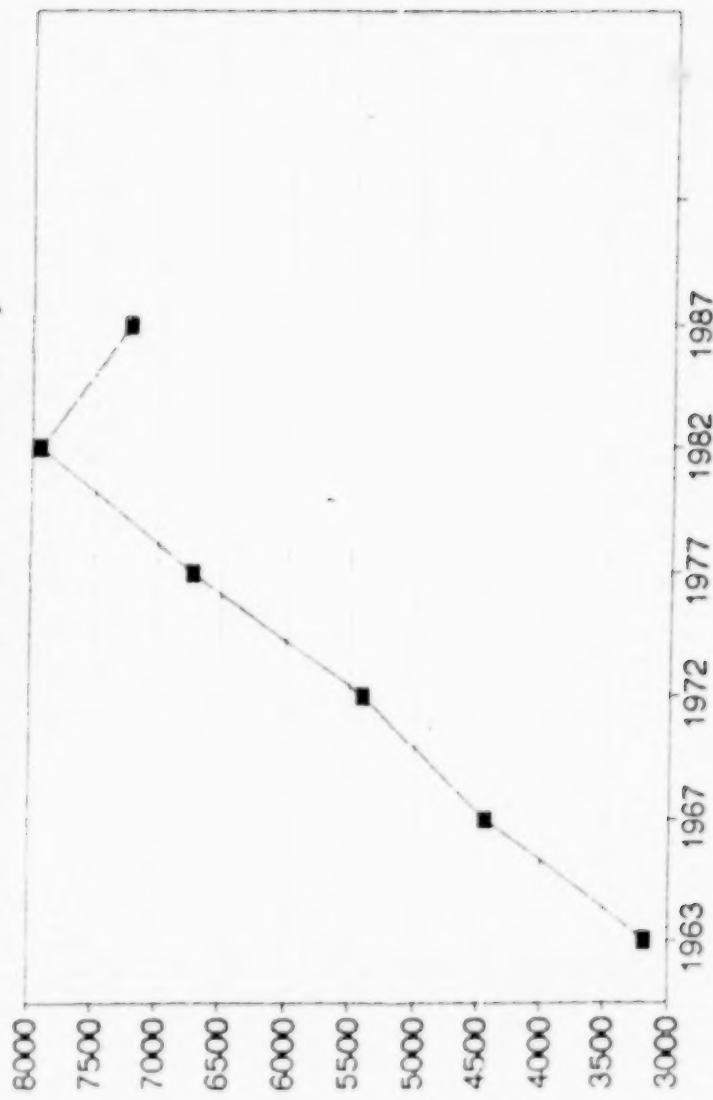


Figure 1

Growth of Mail Order Establishments, 1963-1987

26a

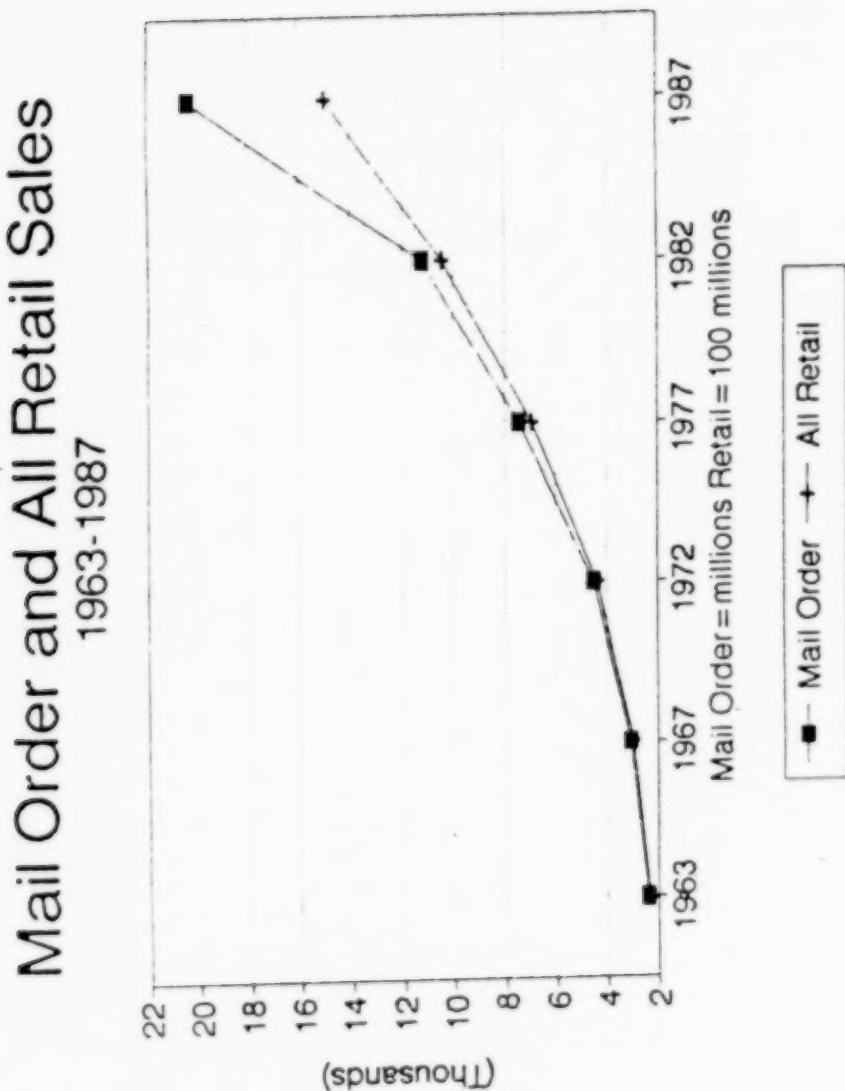


Figure 2
Growth of Mail Order and Retail Sales, 1963-1987

27a

APPENDIX C

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

DIRECT MARKETING ASSOCIATION, INC.,) No. CIV S-88-1067
) MLS-EM
PLAINTIFF,)
)
vs.) STIPULATIONS
WILLIAM M. BENNETT, et al.)
)
DEFENDANTS. ¹)

¹ This case, an injunction action, was filed in 1988 by the Direct Marketing Association (DMA), a trade association of mail order retailers. It sought to thwart California's enforcement of CALIF. REV. & TAX CODE ANN. §6203(f) as to out-of-state mail order companies. In order to avoid the jurisdictional prohibition of the Eleventh Amendment, DMA complained against individuals, present and former elected members and employees of the California State Board of Equalization. In order to avoid the Tax Injunction Act, DMA alleged that such retailers, as use tax collectors only, had no access to California's sufficient and longstanding post-payment refund remedies. The district court granted the Board's motion to dismiss, citing the Tax Injunction Act and federal and state appellate decisions in which the California remedies were made available to use tax collectors. The Ninth Circuit reversed (916 F.2d 1454), inexplicably determining that California's remedies are "uncertain" for use tax collectors, and consequently holding that the Tax Injunction Act did not bar federal jurisdiction. This Court declined to issue a writ of certiorari. (Docket No. 90-1400). The district court subsequently determined that DMA had standing and ruled irrelevant the post-complaint assessment actions by the Board, through which California's remedies became patently certain as to at least 110 mail order retailers. The district court then granted summary judgment for DMA, nonetheless observing

(Continued on following page)

STIPULATIONS

The Plaintiff, Direct Marketing Association, and the Defendants, William M. Bennett, et al., hereby agree to the following stipulated facts. The factual submissions set forth herein are not an admission of relevancy of any of the stipulated facts, do not prevent the parties from arguing legal conclusions and do not constitute a waiver by any party of the facts set forth and/or legal positions asserted in any previously filed pleading or motion.

1. Plaintiff, Direct Marketing Association, Inc. ("DMA"), which filed the instant action on August 19, 1988, is a trade association whose members include entities, with places of business solely outside California (hereinafter "Direct Marketers"), whose business activities are described below and which are engaged in the nationwide direct-to-the consumer mail advertising and marketing of products through orders for products accepted by mail or telephone and through shipments of products to customers by common carriers and/or the United States Postal Service (hereinafter "USPS").

2. Defendants are or were elected members or employees of the California State Board of Equalization (hereinafter "SBE"). SBE is an agency of the State of California charged with the administration of the sales and use tax laws of the State of California. Said laws

(Continued from previous page)

that the Board had presented a number of meritorious arguments why *National Bellas Hess* should be reversed, modified or overruled. At present the case is again before the Ninth Circuit, on appeal by the Board.

include section 6203 of the California Revenue and Taxation Code (hereinafter "section 6203").

3. The State of California enacted amendments to section 6203, effective January 1, 1988 and March 30, 1988. As of August 19, 1988, and at present, section 6203 provides:

[E]very retailer engaged in business in this state and making sales of tangible personal property for shortage, use, or other consumption in this state, . . . shall, at the time of making the sales or, if the storage, use, or other consumption of the tangible personal property is not then taxable hereunder, at the time the storage, use, or other consumption becomes taxable, collect the tax from the purchaser and give to the purchaser a receipt therefor in the manner and form prescribed by the board.

"Retailer engaged in business in this state" as used in this and the preceding section means and includes any of the following:

(a) Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business.

(b) Any retailer having any representative, agent, salesman, canvasser, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or the taking of orders for any tangible personal property.

(c) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

(d) Any retailer soliciting orders for tangible personal property by means of a telecommunication or television shopping system (which utilizes toll free numbers) which is intended by the retailer to be broadcast by cable television or other means of broadcasting, to consumers located in this state.

(e) Any retailer who, pursuant to a contract with a broadcaster or publisher located in this state, solicits orders for tangible personal property by means of advertising which is disseminated primarily to consumers located in this state and only secondarily to bordering jurisdictions.

(f) Any retailer soliciting orders for tangible personal property by mail if the solicitations are substantial and recurring and if the retailer benefits from any banking, financing, debt collection, telecommunication, or marketing activities occurring in this state or benefits from the location in this state of authorized installation, servicing, or repair facilities.

(g) Any retailer owned or controlled by the same interests which own or control any retailer engaged in business in the same or a similar line of business in this state.

(h) Any retailer having a franchisee or licensee operating under its trade name if the franchisee or licensee is required to collect the tax under this section.

(i) Any retailer who, pursuant to a contract with a cable television operator located in

this state, solicits orders for tangible personal property by means of advertising which is transmitted or distributed over a cable television system in this state.

(j) Notwithstanding Section 7262, a retailer specified in subdivision (d), (e), (f), (g), (h), or (i) above, and not specified in subdivision (a), (b), or (c) above, is a "retailer engaged in business in this state" for the purposes of this part and Part 1.5 (commencing with Section 7200) only.

4. Direct Marketers maintain no offices, outlets stores, warehouses or other facilities, stock of goods, real property or employees in California.

5. Direct Marketers' employees do not enter California to perform any business on behalf of Direct Marketers.

6. Direct Marketers have no agents, independent contractors or representatives of any kind in California soliciting sales on their behalf.

7. Direct Marketers do not maintain bank accounts of any type in California or contractual relationships with any bank or other financial institutions located in California.

8. Direct Marketers do not ship products to California customers from any location in California. Direct Marketers ship ordered products from their facilities, which are not located in California, to their customers nationwide by USPS and by United Parcel Service, Federal Express and other common carriers.

9. Direct Marketers send catalog and/or mailings to intended recipients nationwide, including those with California address, by USPS from locations outside California. The printing and pre-printing work for such catalogs and mailings is accomplished outside California. Catalogs are sent to persons listed on Direct Marketers' mailing lists, which contain the names of customers of Direct Marketers and names acquired from companies located outside of California.

10. Customers ordering products from Direct Marketers either 1) mail their orders to Direct Marketers through the United States mail, or 2) place their orders by telephoning Direct Marketers' facilities using the "800" telephone numbers of Direct Marketers. Direct Marketers have no local telephone listings in California.

11. Customers ordering products by mail from Direct Marketers use order forms accompanying the catalogs or mailings. Payments for mailed-in orders are either by check, with funds payable to Direct Marketers, or by charge to customers' credit cards. The mail-in order forms request, for charge orders, that customers specify the type of credit card (for example, VISA, MasterCard, Discover or American Express), the card account (or "BIN") number, and the card expiration date.

12. Telephone orders are received by Direct Marketers at their non-California facilities through the customers' use of an "800" telephone number provided to the Direct Marketers by local telephone companies, located outside California, and AT&T or another long distance telephone carrier. Direct Marketers pay the cost for calls placed on their "800" telephone numbers. The

"800" telephone numbers of Direct Marketers apply to calls from customers throughout the United States, including telephone calls originating in California, and for some entities are accessible by customers 24 hours a day. In placing telephone orders customers provide Direct Marketers with a description of the merchandise ordered, as well as the type of credit card (for example, VISA, MasterCard, Discover or American Express), the card account (or "BIN") number and the credit card expiration date and the customer's telephone number.

13. Direct Marketers do not know the name or location of the bank which issued a credit card used to make a purchase.

14. Direct Marketers provide warranties of customer satisfaction such that, if at any time the customer returns to a Direct Marketer merchandise which was ordered from and shipped by that Direct Marketer, the customer will receive a replacement or refund. If the merchandise is lost by the customer or lost in transit when shipped by the customer to the Direct Marketer, the customer will not be entitled to a refund or replacement.

15. Over one-half of the sales by Direct Marketers are accomplished through the use of credit cards (for example, VISA, MasterCard, Discover and American Express). A substantial portion of the credit card sales of Direct Marketers to California customers are charged to the customers' VISA and MasterCard credit cards issued by California financial institutions.

16. Direct Marketers' catalog and mail solicitations of, and sales to, California customers are substantial and recurring. However, Direct Marketers do not regularly

advise DMA of their sales volumes or the number of separate sales or the volume or page numbers of their catalog or mail solicitations or the period following such solicitations during which offered products remain available for purchase.

17. Subsequent to January 1, 1988, SBE notified Direct Marketers of the requirement, pursuant to section 6203(f), that Direct Marketers register with SBE, and collect and remit use taxes for sales to California customers, on the basis that 1) Direct Marketers' catalog and mail solicitations of, and sales to, California customers are substantial and recurring, and 2) Direct Marketers derive a benefit from banking activities occurring in California by accepting for purchases by California customers credit cards issued by California financial institutions. SBE has also informed Direct Marketers that enforcement actions, including the issuance of determinations to individual entities, would be taken if Direct Marketers did not register, collect and remit use taxes. SBE has taken enforcement actions including the issuance of determinations to individual Direct Marketers. SBE is unaware of which of the Direct Marketers who received such notifications are members of DMA.

18. For VISA and MasterCard credit card orders, Direct Marketers do not ship ordered products unless an approval code for the charge is communicated to Direct Marketers by Direct Marketers' banks, which subsequently purchase approved VISA and MasterCard transactions ("acquiring banks"), or by independent companies called processors, through an electronic communication from acquiring banks or processors to the direct marketers. Direct

Marketers' acquiring banks and processors are located outside of California.

19. If Direct Marketers request electronic approval from processors instead of from acquiring banks, and if such approval is granted or denied, acquiring banks are not involved in this aspect of the authorization process. If acquiring banks provide authorization codes to Direct Marketers approving or denying the transaction, the acquiring banks do not record such information.

20. Pursuant to agreements between Direct Marketers and the acquiring banks, the banks provide the Direct Marketers with electronic equipment enabling Direct Marketers to communicate with the acquiring banks or processors to ascertain whether or not approval is granted for purchases charged on customers' VISA or MasterCard credit cards. The acquiring banks or processors, in turn, communicate with Direct Marketers, informing them if the charge to VISA or MasterCard was approved or disapproved or whether contact with a call authorization center is needed for approval. A call authorization center is provided for the benefit of acquiring banks by another entity with which the acquiring banks contract. Call authorization centers are located outside of California. Direct Marketers which contact call authorization centers do so by telephone. Call authorization centers request information from issuing banks, defined below, regarding approval of a purchase. Call authorization centers subsequently communicate the information obtained from the issuing banks to the direct marketers. Call authorization centers may request specific information from Direct Marketers such as the type of products

to be purchased. Call authorization centers may then transmit such information to issuing banks.

21. Direct Marketers' banks (the acquiring banks) are members of VISA and MasterCard, either directly or through an association of financial institutions.

22. Direct Marketers have no contractual relationship with VISA or MasterCard or their parent organizations, VISA, International and MasterCard, International.

23. The electronic equipment provided to Direct Marketers by their banks, which allow Direct Marketers to communicate with their banks or processors, require Direct Marketers to input the credit card account number, expiration date, and the amount of the intended purchase in order to determine whether the purchase is approved. If an approval code is obtained, this information is recorded by Direct Marketers on their order forms.

24. For each approved VISA or MasterCard credit card purchase, Direct Marketers generate a separate document, or computer entry. Each business day, Direct Marketers compile these separate documents or entries and submit them to the acquiring banks. Pursuant to their agreement with Direct Marketers, acquiring banks purchase these approved VISA and MasterCard transactions from Direct Marketers at a discount rate negotiated between the bank and the Direct Marketer. The discount fee, in part, is determined by acquiring banks' overhead costs, including the interchange fees charged by VISA and MasterCard, as defined below, and other overhead costs such as supplies, stationery, salaries, building maintenance and computer processing for the banks as a whole.

25. Under the terms of Direct Marketers' agreements with their banks, Direct Marketers are entitled to, and in fact receive, payment on all approved VISA and MasterCard transactions delivered to acquiring banks. In other words, Direct Marketers' banks are obligated to purchase all approved VISA and MasterCard transactions submitted by Direct Marketers. There is no risk to Direct Marketers if their banks do not obtain collection. Direct Marketers have no involvement with respect to VISA and MasterCard charges other than (i) electronically communicating with acquiring banks or processors to obtain approval for these charges and (ii) submitting approved orders to acquiring banks for purchase by these banks. If a credit card holder asserts to the issuing bank that his or her credit card was fraudulently used, the issuing bank will charge the acquiring bank for the amount of the transaction. The acquiring bank will then charge the Direct Marketer for the amount of the purchase.

26. VISA, U.S.A., and MasterCard, International, are separate entities which are comprised of financial institutions or financial institution association members. These entities may be (i) licensed to use the VISA or MasterCard mark; (ii) licensed to issue VISA or MasterCard cards, *i.e.*, act as issuing banks; or (iii) authorized to purchase VISA and MasterCard transactions from merchants, *i.e.*, act as acquiring banks.

27. Acquiring banks and processors enter into agreements with Direct Marketers which solely govern the relationship between the acquiring bank or processor and Direct Marketer regarding the Direct Marketer's acceptance of payment by VISA or MasterCard from its customers.

28. In 1990, VISA had approximately 110,000,000 accounts in the United States. In 1988, there were approximately 55,000,000 MasterCard accounts. In 1990, approximately 500 California financial institutions were licensed to issue VISA cards. In 1990, 713 California financial institutions were licensed to issue MasterCard cards.

29. VISA and MasterCard card-issuing banks set the level of credit which their customers can charge to their cards. The card-issuing banks determine the fee, if any, to charge their cardholders, which fee is not shared with VISA or MasterCard or any other members of VISA or MasterCard.

30. Both VISA and MasterCard provide acquiring banks with an option of having VISA and MasterCard communicate with issuing banks. Acquiring banks may decline to use VISA and MasterCard for such communications. Direct Marketers who request an approval code from their acquiring bank or from processors have no involvement in any of the communications between the acquiring banks or processors, on the one hand, and the issuing banks, on the other hand. When acquiring banks or processors receive the authorization information from the issuing banks, that information is, in turn, communicated by the acquiring banks or processors to the Direct Marketers.

31. Whether approval information is requested by acquiring banks or processors, such entities first directly seek this information from the issuing banks and then give the issuing banks' response (for example, approving the transaction) to the acquiring banks or processors,

which, in turn, give the information to the Direct Marketers. If the issuing bank cannot be contacted (e.g., its computers are "down"), VISA or MasterCard may approve or deny the transaction based upon criteria and information provided by the issuing bank and communicate this information to the acquiring bank or processor, which, in turn, gives it to the Direct Marketers. In the latter case, the issuing bank is not involved in the communication between VISA or MasterCard and the acquiring bank or the processor.

32. MasterCard and Visa require issuing banks to provide 24-hour approval capability whether or not the approval for a particular transaction comes from VISA or MasterCard, the issuing bank, or an independent processor.

33. The VISA and MasterCard by-laws state that if an approval code given by the issuing bank was validly communicated to the acquiring bank or processor (and, in turn, communicated to Direct Marketers) regarding a VISA or MasterCard transaction which the acquiring bank has purchased, the acquiring bank will be credited for the transactions it has purchased with the issuing institution bearing the risk of collecting on the debt from its customers, the credit card holder.

34. VISA and MasterCard also provide acquiring and issuing banks the option to go through VISA or MasterCard, via electronic communications, for settlement functions. Direct Marketers have no involvement in this function. Acquiring banks and issuing banks may, alternatively, decide not to involve VISA or MasterCard

for this function. Approximately 35% to 45% of VISA transactions are not processed through VISA.

35. The VISA interchange fee is intended to balance the costs in the payment stream. The VISA interchange fee is set by the Board of Directors of VISA based upon a statistical analysis of costs in the industry. The net flow of interchange fees is to the issuing institution because there are more costs of this "side" of the transaction. One of the bigger costs for those VISA issuing members who offer customers a "grace period" before charging interest on outstanding balances involves "float," the cost of money to the issuing bank before the account holder is billed by the issuing bank for the transaction and the issuing bank receives payment. The VISA interchange fee is paid by the acquiring bank to the issuing institution and is intended to compensate the issuing institution for costs with respect to the VISA system. The setting of the interchange fee is unrelated to the purchase price for credit card transactions paid by the acquiring bank to the Direct Marketer.

36. In setting the standardized interchange fees, MasterCard's board of directors considers industry-wide factors including the issuing banks' costs of funds, credit losses, and fraud losses. The MasterCard interchange fee is intended to compensate the issuing institution for costs with respect to the MasterCard system. The setting of the interchange fee is unrelated to the purchase price for credit card transactions paid by the acquiring bank to the merchant.

37. In undertaking the optional settlement function, VISA and MasterCard are transmitted electronic files

from acquiring banks reflecting the credit card transactions purchased from merchants by the acquiring banks. VISA and MasterCard determine which issuing institutions are involved in each of the transactions by translating a confidential code incorporated into the credit card BIN number. VISA and MasterCard then electronically advise the issuing institution or an intermediary processor of the transactions so that they may be posted to the proper card account at the issuing bank. VISA and MasterCard then calculate the fees involved and advise their settlement banks to appropriately credit or debit each banking institution or intermediary processor. VISA and MasterCard have no means of identifying the particular merchant involved in a given transaction.

38. If an issuing bank has failed or cannot settle on a particular day, VISA or MasterCard will "cover" settlement (i.e., make payment to the acquiring bank) so that there is no risk to the acquiring bank which has purchased an otherwise valid VISA or MasterCard transaction. If the failed bank is a member of an entity which is an association member of MasterCard, MasterCard will look to the association to "cover" the settlement.

39. Issuing banks are responsible for maintaining their own accounts with their customers (the cardholders). Issuing banks are free to establish the terms of their agreements with their customers, including credit limits, grace periods, and annual percentage rates to be applied to outstanding balances. Issuing banks post purchases and bill cardholders pursuant to these agreements.

40. In collecting upon delinquent VISA and/or MasterCard accounts, an issuing bank has available to it

statement "duns," telephone calls to accounts holders, referral to collection agencies, and lawsuit against its cardholders.

41. VISA provides some acquiring banks and issuing banks, or their independent processors, with electronic equipment known as "access points." VISA also provides some banks with software which permits the banks to use "access points" to communicate electronically with VISA should the banks decide to communicate with VISA regarding approval and/or settlement.

42. MasterCard requires that acquiring and issuing banks maintain computers which have a standard telecommunications hook-up so that the banks can communicate electronically with MasterCard.

43. Neither VISA nor MasterCard specify the type of hardware or software that Direct Marketers maintain to obtain approval for VISA or MasterCard transactions.

44. VISA, U.S.A. is a member of VISA International. Both entities have a principal place of business in California.

45. MasterCard's principal place of business is in New York, New York. MasterCard has two sales offices and a computer center located in California.

DATED: May 24, 1991

/s/ <u>Steven J. Green</u>	/s/ <u>John A. Mendez</u>
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APPENDIX D
IN THE CHANCERY COURT
FOR THE STATE OF TENNESSEE
20TH JUDICIAL DISTRICT, DAVIDSON COUNTY
BLOOMINGDALE'S BY MAIL LTD., :

Plaintiff,	:
v.	:
JOE B. HUDDLESTON, Commissioner of Revenue,	:
and CHARLES W. BURSON, Attorney General of Tennessee,	:
Defendants.	

AFFIDAVIT OF RAY WESTPHAL

STATE OF PENNSYLVANIA)

COUNTY OF CHESTER)

RAY WESTPHAL, after being duly sworn in accordance with the law, makes oath as follows:

1. I am the President of Vertex, Inc., located in Beryn, Pennsylvania. I have personal knowledge of the facts set forth below.
2. I have been the President of Vertex, Inc., since 1978 and was employed by its predecessor corporation from 1974 to 1978. My prior employment includes computer consulting work with the accounting firm Peat Marwick from 1967 to 1971, and with the Educational

Testing Service, of Princeton, New Jersey, from 1961 to 1967. In the course of such employment, I have accumulated 29 years of experience in developing and adapting computer systems to meet the varied needs of many kinds of businesses.

3. I am the author of an article, entitled "The Computer's Role in Simplifying Compliance with State and Local Taxation," which was published in the May 1986 edition of the Vanderbilt Law Review.

4. As President of Vertex, Inc., I have developed and overseen the development of a computerized sales tax compliance system which is specially suited for use by companies whose business reaches into a multitude of state and local taxing jurisdictions throughout the United States. Vertex, Inc., is the nation's leading supplier of computer systems designed to handle the administrative and accounting tasks faced by a company in complying with state and local sales and use taxes in multiple taxing jurisdictions. The Vertex computerized sales tax compliance system consists of three main elements:

(a) The Data Module contains complete state and local sales and use tax rate information for every taxing jurisdiction in the United States. This information is updated on a regular, monthly basis, through our constant communications with taxing jurisdictions nationwide.

(b) The Calculation Module integrates the state and local tax rate information directly into the user's own computerized billing systems, calculates the appropriate tax on each transaction, and generates management reports. At the user's choice, and depending on its needs,

transactions are identified to specific taxing jurisdictions by zip code, zip code plus city name, FIPS (Federal Information Processing Standard), or by our proprietary Geo-Code system.

(c) The Returns Module uses the information from the Calculation Module to generate automatically state and local tax returns, on appropriate forms, for each taxing jurisdiction.

5. The Vertex sales tax compliance system works with virtually any major mainframe computer or mini-computer, and can also run on virtually any IBM personal computer or compatible equipment, with no special configurations needed. Any company which uses computers to handle its billings, mailing lists, or similar functions, probably already has the hardware necessary to make full use of the Vertex system.

6. The system described above enables companies to eliminate the burdensome, labor-intensive process of calculating taxes and preparing tax returns manually, and thus to minimize both the costs of compliance and the expensive human errors (and the consequent penalties, late-filing fees, and interest charges) which can occur when taxes are handled manually.

7. The computerized Vertex sales tax compliance system is currently in place with and used by approximately 1000 corporations. In my experience with dealing with such customers, I have found that typically, depending on the nature and the needs of the business, at least half of the man-hours per month which were expended on sales tax compliance before computerized systems were used, can be eliminated by use of the Vertex system.

Thus, a typical company owing sales tax to numerous state and local taxing jurisdictions can, by using the computerized Vertex system, cut the man-hours, and thus other costs, associated with tax compliance by at least 50%.

8. The basic Vertex sales tax compliance system, as described above, is priced at about \$12,700.00 for initial installation, and about \$10,000.00 per year thereafter for maintenance, updates, and related services. An extra charge is made if the customer chooses to take advantage of our proprietary GeoCode system. Vertex, Inc., also markets other products and services, for which separate charges are made.

9. More information about the Vertex sales tax compliance system is provided in our brochure, a true copy of which is attached here as Exhibit A.

10. The Vertex computerized system has been available on the market since 1975, and of course has been improved and updated since that time.

11. Although Vertex, Inc., is the leading supplier in the United States of systems such as that described above, there are other companies which also market computer programs for sales tax compliance.

12. Neither I nor Vertex, Inc., take any position regarding the interpretation, correctness, or applicability of the decision in the *National Bellas Hess* case.

/s/ Ray Westphal
RAY WESTPHAL

Sworn to and subscribed before me, this 8th day of January, 1991.

/s/ Helen Roth
NOTARY PUBLIC

My Commission expires:
11/15/93

[seal]

Exhibit A

[Text of the Vertex brochure, omitting illustrations]
VERTEX™

SalesTax™
Compliance
System

"It takes the worry out of sales tax compliance - from the moment we write an order right through filing returns."

System

If you do business, now you've got a better way to handle sales tax compliance.

It's SalesTax™, the remarkable system for PCs, mainframes, and minicomputers that handles sales tax compliance from calculation and billing right through returns filing - eliminating labor-intensive, error-prone manual calculation and returns preparation.

No matter how many taxing jurisdictions you operate or sell in, SalesTax™ makes

- Looking up sales and use tax rates,
- Calculating taxes,
- Interfacing with your billing system,
- Preparing tax returns, and
- Generating management reports

fast and easy.

And it does all this at a fraction of the *true* cost of manual systems.

Three modules/One system

SalesTax's exceptional speed, power, and ease of use come from its modular design.

The SalesTax *Data Module* contains complete state and local rate information, updated monthly.

The *Calculation Module* integrates this data directly into your computerized billing program, calculates taxes automatically, and produces management reports.

And the *Returns Module* uses the data from the Calculation Module to produce state and local tax returns automatically.

ALL U.S. AND CANADIAN SALES AND USE TAX RATES

The SalesTax Data Module - available on magnetic tape or PC-system diskettes - contains data for over 50,000 locations in the United States, its Trusts and Possessions, and Canada.

All current U.S. taxing entities are included in the SalesTax file. In addition - because new taxes can be imposed at any time - *all* states and counties are on file, as well as all cities with populations over 250.

Vertex stays in constant contact with taxing states, and self-administered localities, to stay abreast of sales/use tax rate changes, and updates are issued monthly.

The Data Module contains both the current and the previous sales, use, and rental tax rates - obtained directly from the taxing jurisdictions. The effective date of each current rate is provided and is updated with each rate change.

TAX CALCULATION - QUICK, ACCURATE, AUTOMATIC

The SalesTax Calculation Module is designed to interface effortlessly with *any* commercial or custom developed billing software. Based on the parameters given by your billing program, SalesTax determines

- If the transaction is interstate or intrastate.
- The tax rates to be applied.

- The taxability of freight, parts, labor, expense, and federal excise tax*, and
- Maximum tax base and excess amounts, if applicable.

Your billing program may override any SalesTax parameter, and may supply additional information, such as exemption information.

SalesTax then

- Retrieves the appropriate tax rates.
- Calculates tax amounts.
- Returns these amounts to your billing program, and
- Stores the information for management reports and returns preparation.

And because the state, county, and city rate data are all carried *separately* in the Data Module, SalesTax can calculate these three levels individually – a necessity for reporting tax collections to states that require detailed breakdowns of local taxes.

Takes exceptions in stride

State and local tax laws are full of exceptions, and SalesTax is designed to accommodate *all* of them, including

* The taxability of freight, parts, labor, expenses and federal excise tax are determined according to the general rules applied by the states.

- **Tax rate overrides and partial rates**

In several states, city taxes may override a county tax; or a city will pick up a part of the county rate; or a city or county part of the state rate. SalesTax flags these overrides or partial rates in the city record to ensure correct calculation of taxes for that city.

- **Maximum rates on dollar amounts**

In some states the sales tax law includes provisions for maximum tax amounts for cities and counties. Base dollar amounts – for single items or single sales – may be taxed at the standard rate, and amounts in excess of the base at another. SalesTax carries the base amount, maximum tax, and excess rate in the county and city records, where applicable, and applies this information when calculating county and city taxes.

- **Locally administered taxes**

SalesTax automatically identifies cities and counties that are locally administered and directs the filing of returns accordingly.

- **Other special conditions**

Some companies – because of the type of business they're in, the products they sell, the type of customers they have, or how they do business – require rates other than the general rates carried in the SalesTax Data Module. No problem. SalesTax will help you create and maintain your own custom tax exception files.

TAX FILING - CLOSING THE LOOP

SalesTax's Returns Module completes the sales tax cycle by preparing state and local returns with the same speed and efficiency as the rest of the SalesTax system - saving time and effort and reducing your audit exposure.

Simple as 1-2-3®

The Returns Module is a full-featured application built around Lotus' 1-2-3, the world's most widely used business productivity software.

So, if you're one of the tens of thousands of businesses that use Lotus 1-2-3, you already know most of what you need to know to start using the Returns Module right away.

Easy to learn . . . and use

The Returns Module makes tax filing fast and easy.

Data is "downloaded" directly from the SalesTax Calculation Module. Then your PC does the rest, calculating, formatting, and printing your returns - one at a time or as a batch.

Clear, organized menus and Help screens, in plain English, guide you through the entire process.

Signature-ready returns

The SalesTax Returns Module will prepare all the forms you need to file - including sales and use tax

returns, return worksheets, schedules, and consolidated report forms for both state and local jurisdictions.

In most states, these forms are approved for submission just as they come from your printer. Even where they're not, their layout identically matches each jurisdiction's return format, so it's simple to transfer or attach information to official return forms.

Finally, SalesTax generates a check request, referencing your internal general ledger account number.

More accurate, timely filing

SalesTax eliminates time-consuming manual return preparation, and its attendant human-factor errors.

With SalesTax, your returns will be prepared on time. And your exposure to late charges and state audits - maybe even your need for staff - will be reduced.

Even if you *are* audited, SalesTax gives you a clear, easy-to-understand audit trail of detailed management reports for demonstrating compliance.

Runs on the most popular hardware

Best of all, the SalesTax Returns Module runs on virtually any IBM® PC or compatible with 640K RAM - with no special configurations required. Chances are, you already own all the equipment you need to start taking advantage of the Returns Module.

MANAGEMENT REPORTS

SalesTax provides an array of valuable management reports to help you see where you've been . . . and where you're going.

Sales Tax Register

Using data stored by the Calculation Module, SalesTax can produce detail and summary Sales Tax Register reports – sequenced by state, county, and city – for any billing period.

At each geographic level, totals for taxes, taxable sales, and exempt sales are automatically provided and broken into the appropriate state, county, and city taxes due, allowing transfer to the Returns Module. Rapid transit taxes are distinguished and reported separately from county and city taxes.

A recap report will be automatically generated with either register format, containing state recaps and grand totals.

Gross Receipts Report

This report provides helpful information on gross receipts distribution, including a "ship-to" summary and a state-level "ship from/ship to" breakdown.

History Report

SalesTax will also retrospectively summarize Tax Register or Gross Receipts information by week, month, YTD, or annually.

GEOCODE™ – THE BETTER LOCATION CODE

SalesTax provides several options for describing the geographic location for rate lookup: ZIP, ZIP plus city name, FIPS (Federal Information Processing Standard), and our own proprietary GeoCode™.

Because different businesses have differing needs, the most appropriate code for your business will depend on your transaction volume and the cost of individual items. But GeoCode offers several distinct advantages.

GeoCode eliminates the problems of ZIP and county boundaries that don't match and of frequently-changing ZIP Codes. And, because the GeoCode Master File is maintained by Vertex, you benefit from a stable file that's always up-to-date.

If you choose GeoCode or FIPS, you may be interested in using the Vertex GeoCoder™ system to upgrade your customer master file with GeoCodes, using existing ZIP Codes and city names from your file for automatic conversion. The GeoCoder system is available as a service or for in-house use.

HANDY REFERENCES

Along with the powerful SalesTax software, customers receive two valuable hard-copy references.

Vertex National SalesTax Rate Directory™

The National SalesTax Rate Directory™ is useful for checking rates and for manual billing. Rates for each taxing jurisdiction are presented in a convenient state-by-

state format, and monthly replacement page updates are automatically provided.

GeoCode™ Master List

A copy of the Master GeoCode List is also provided with the SalesTax system. Entries are listed alphabetically by state and by locality within each state. Updated lists are sent to all users annually.

Satisfaction guaranteed

We're convinced you can't find an easier, more powerful, more comprehensive way to manage sales tax compliance than SalesTax, and we back that conviction up with a simple promise: you'll like it, or we'll take it back.

If at any time during your startup period you're not 100% satisfied, just return it for a complete refund - no questions asked.

SalesTax - YOUR TAX EDGE

Add it up. No other system can match the benefits of Sales Tax

- ✓ More accuracy, less work
- ✓ Simple operation
- ✓ Nationwide coverage
- ✓ Up-to-the-minute information
- ✓ Assured tax compliance
- ✓ Better management information

- ✓ Unparalleled support
- ✓ Single-source convenience
- ✓ Turnkey operation
- ✓ Satisfaction guaranteed

To find out how SalesTax can give you sales tax confidence, call (215) 640-4200.

LARGE-SYSTEM POWER OR SMALL-SYSTEM CONVENIENCE

No matter how your business is automated, there's a version of SalesTax that works the way you work. Choose our user friendly PC version. Or our COBOL or RPG II/III versions for all major mainframe and minicomputers.

Either way you'll enjoy the advantages of fast, accurate tax calculation and easy, error-free returns preparation.

System Requirements

SalesTax is available for all mainframe and mini systems, including:

Alpha Micro	Hewlett-Packard	NCR
Amdahl	Honeywell	NEC
Basic Four	IBM	Perkin-Elmer
Data General	Magnuson	Prime
DEC	MDS Qantel	Tandem
Four Phase	Microdata	Unisys
Harris	NAS	Wang

For PC operation, you'll need

- IBM® PC, PC/XT® or AT® (or compatible)
640K RAM
Diskette drive (5¹/₄" 1.2 MB or 3¹/₂" 1.4 MB)
Hard disk drive (Will use up to 10 MB)
- MS™-DOS or PC-DOS, Version 2 or later
- Lotus® 1-2-3®, Release 2.01 or higher
- Most Epson FX series dot-matrix or Hewlett-Packard LaserJetII® printers

What you'll get

For COBOL or RPG II/III versions, all files and source programs in your choice of

- 1600 BPI, or
- 6250 BPI
- ASCII, or
- EBCDIC tape formats

For PC-based systems

- All files and programs
On 5¹/₄" normal or high-density diskettes
Or on 3¹/₂" diskettes

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MS-DOS is a trademark of Microsoft Corporation.

SOLID SUPPORT

Plus, you'll get the expert, personalized backup that is a Vertex hallmark.

Including installation support (and six months of supported parallel operation) for a smooth cutover. Clear documentation. Telephone hotline support.

And, for a surprisingly affordable hourly rate. Vertex consulting service for customized, up-to-the-minute advice on any tax compliance question.

Vertex is the only place you'll find such a depth of service and information . . . and such confidence.

WHAT OUR CUSTOMERS SAY ABOUT US

But don't take our word for it. Listen to what our customers have to say about us.

"The cost was much less than what we would have spent internally to create an appropriate data base for our tax and marketing needs."

Julius J. Figula
Manager of Systems and Programming
The Scribner Book Companies, Inc.

"Preparing returns manually simply doesn't make sense – in terms of both the time it takes and the potential for error and late filing. SalesTax's fast, accurate return preparation does make sense."

Joseph R. Ochoa
Senior Tax Accountant
Computer Associates

"Tapes are received on time every month. We just load the new tape each month and start processing - never a hitch."

John Ruster
Programmer/Analyst
Herman Miller, Inc.

"Nobody offers the kind of top-to-bottom system that Vertex does. For us, that means better service, lower price, and most of all confidence."

Robert Thalman
Tax Supervisor
Curtin-Matheson Scientific

"Vertex is always there when we need them. The system works - never a problem."

Richard Maahs
Senior Systems Analyst Programmer
Miller Fluid Power

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